Financial Administration in India

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By the same author

FINANCE OF FOREIGN TRADE AND FOREIGN EXCHANGE

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TO
THE CHERISHED MEMORY OF
MY REVERED MOTHER
KARTAR KAUR
(1903-1939)

PREFACE

Financial administration as a system, through which the State conducts its financial business and exerts influence on the level of economic activity, holds a unique practical significance in a parliamentary democracy. The Indian financial system, though developed on the British pattern, has undergone radical changes since Independence, under the impact, particularly, of: (a) adoption of a federal Constitution on January 26, 1950; (b) institution of State-initiated and State-directed process of planned development since April 1951; (c) increasing participation of the State in the process of economic growth with the consequent pressures on resource-mobilisation, resulting in a growing financial involvement of the Union and State governments on account of both administrative and developmental expenditures; and (d) the emergence of a changing Union-State fiscal relationship.

This changing character of the system has attracted not an inconsiderable amount of attention at academic, administrative and political levels. Very recently the Administrative Reforms Commission have conducted a thorough examination of the system and recommended measures to adapt it so as to serve adequately the changing situations. In order to meet a long felt need, therefore, the present book is a modest attempt at an analytical treatment of the subject, in the context of the changing framework, under which the Indian financial system in operating.

The book covers a wide range of subjects, viz., Union-State fiscal relationship; the Finance Commission and the Planning Commission, and their respective roles in the emerging context; various stages of the budgetary process — preparation, legislative sanction, execution, system of accounts and audit, and system of parliamentary financial committees; analysis of the trends in the finances of the Union and State governments since 1950-51; an analytical account of the trends in and structure of public debt since 1950-51; theoretical implications of price policy of public enterprises; and the concept of performance budgeting and its implications in the Indian context.

In this attempt, the author owes a debt of deep gratitude to a number of authorities; both in this country and outside, on whose specialised knowledge he has the privilege to draw. More particularly, the monumental studies undertaken by the Administrative Reforms Commission and the various Working/Study Groups appointed by them have been an invaluable sources of reference.

The views, wherever expressed in the text, are the personal observations of the author and are put forward to stimulate purely academic discussion. They should in no way be attributed to the author in his official capacity or the organisation which he has the privilege to serve.

To acknowledge the contribution of each person who has in one way or the other stimulated the author to write this book would require a long list indeed. The author cannot omit, however, an avowal of debt to his friend Shri Harkishan Lal Kapoor and acknowledges gratefully his influence which has been pervasive and long-lasting.

The manuscript was typed by Shri S.L. Goel, whose immense sense of dedication and perseverance are thankfully acknowledged. The author takes this opportunity in expressing his gratitude to Sarvashri M.S. Anand and O.P. Wadhwa of the Planning Commission's Library for their invaluable and ungrudging assistance in providing with the references and source materials whenever needed.

The author extends his sincerest thanks to Shri Prem Nath Kapoor of Messrs H.P.J. Kapoor, the publishers, and Shri Jai Nath for their painstaking efforts to produce this publication with imaculate get-up and printing.

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The Problems of Federal Finance

An essential feature of all the Federal Constitutions is the distribution of sovereign powers between the Union Authorities and the constituent units. A logical corollary to such a distribution of powers is that the financial powers in every federal set-up must be, and usually are, similarly distributed between the Union Authorities and the cosntituent units. The test of the adequacy of the powers of taxation of the Union government or the States depends, therefore, primarily upon the functions assigned to be performed by each of them in their respective spheres. Accordingly, it would be preferable to preface our discussion by an examination of the principles upon which the division of functions, among the Union government on the one hand and the States on the other, in a federal set-up takes place. "Economy, administrative convenience and efficiency have been the leading principles in the distribution of functions. These principles have guided the rival claims of centralization and decentralization. It will appear at once that certain functions can best be performed by the federation, while, others are more suitable for the federating States or local authorities."[1] Thus functions like defence (the

[1]Misra, B.R., *Indian Federal Finance*, Third Revised Edition. Calcutta : Orient Longmans, 1960, pp. 16–17. Although this belief has sometimes been questioned as an arbitrary assumption, the actual experiences of working federations have proved that, by and large, it is true.

largest single head of expenditure), external affairs, foreign trade, railways, national highways, airways, waterways, currency and coinage, the regulation of inter-State commerce and communications, etc., are predominantly national in character, and should be administered by the Union government. Similarly, functions such as maintenance of law and order, education, health and other social security services, agriculture, community development, small industries, etc., can be administered more efficiently by the federating States or local authorities. It must be added, however, that in some cases, in order to secure uniformity of application and progress, it may be desirable to have Union legislation to be administered by the States. Depending upon certain particular considerations, the actual distribution of functions may have resulted in extreme centralisation in some federations or extreme decentralisation in others; but in most cases the tendency has been along the lines indicated above.

The special problems of federal finance, as distinct from unitary finance, arise, therefore, as a result of division of functions between the Union and the State governments. The *first*, and the foremost problem, of a federal financial set-up is to arrive at a decision as to what sources of revenue should be assigned to the Union authorities on the one hand and the State governments on the other, in order to establish an equilibrium n the financial relations of the Union on the one hand and the constituent units on the other, so that their financial needs in respect of their respective functions are met adequately.

Notwithstanding any basis of the division of resources, it is less likely, however, that the financial needs and the available sources of finance of each government would exactly be balanced, i.e., there may often arise shortages *or* surpluses of financial availabilities in relation to the needs arising out of the obligations of such governments. As a consequence, the *second* equally important problem of federal finance is to make adjustments in order to even out these shortages and surpluses. Both these problems, namely the division of resources between the Union and the constituent units and the adjustments arising out of the need for evening out are to be tackled, therefore, in such a manner as to satisfy some basic principles of federal finance according due regard to the special interests of each constituent unit and also that of the country as a whole.

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Basic Principles of Federal Finance

A structure of federal finance is expected to be workable satisfactorily if it provides for : (a) fiscal autonomy and independence for the Union and its constituent units in their respective spheres; (b) adequacy of the financial resources according to the respective needs with built-in elasticity and flexibility; (c) equity; (d) economy; and (e) flexibility. "No matter how well intentioned a scheme may be, or how completely it may harmonize with the abstract principles of justice, if the system does not work administratively, it is doomed to failure."[2] Therefore, whatever the norms on which the financial powers are distributed between the Union and the constituent units, the system must be administratively workable.

Fiscal Autonomy and Independence

The distribution of functions among the Union and the constituent units in a federal set-up may largely remain inoperative if not carried to the fiscal sphere. The revenue raising powers and the spending obligations of the Union and the constituent units follow usually the general lines of demarcation of the subjects identifying the location of political and fiscal sovereignties. The economic justification of such a distribution is found, according to B.P. Adarkar, in that "the basic principle of practical public finance that, as far as it is practicable, the responsibility of raising revenue and the freedom of spending it ought to go hand in hand, must be granted as more or less fundamental to federal, as to other financial system."[3] It has, therefore, been asserted that the division of financial sovereignty must, in all essentials, correspond to the distribution of legislative and executive powers as embodied in the Constitution. The equilibrium of financial relations must depend on the solution of the problem of division of sovereign powers. Precisely, each government should have separate and independent sources of revenue, full powers to impose taxes and other levies, to incur expenditures, and to borrow, in order to carry out its functions and obligations effectively.

Fiscal autonomy and independence may be a sound principle theoretically, but giving effect to the principle of clear cut or complete seperation of resources is bound to be encountered with many difficulties. It is doubtful if this platitude of practical finance can be regarded as fundamental. If the practice be any guide, the tendency is towards a cooperative federalism based on the direction for centralization of revenues and decentralization of expenditure. In most of the countries, unitary and federal alike, the local authorities depend, for most of their financial requirements, on the revenues raised by the States or Central authorities, as the case may be, and the State authorities, in their own turn, now depend,

[2]Seligman, E.R.A., *Essays in Taxation*, Tenth Edition. London : Macmillan, 1951, p. 378.

[3]Adarkar, B.P., *The Principles and Problems of Federal Finance*. London : P.S. King and Sons, 1933, p. 32.

to a larger extent than ever before, on centrally raised revenues. The consequence is that the division of functions in terms of the assignment or subjects vis-a-vis sources of revenue is becoming increasingly unrealistic and the process may ultimately eclipse fiscal independence of the State governments.

Matching of Means and Needs

The principle of matching means and needs presupposes that the means of the Union, State and local governments be matched to their respective needs as determined by the assignment of functions at any given time. Applying the principle to a dynamic process of the growth of the economy, the measurement of needs for due performance of the changing character of the functions and the resource potentials must refer not only to the existing set of circumstances but also to the changing perspective. The financial structure as a whole, therefore, should be elastic and flexible so as to be adaptable, without much strains and stresses, to the changing character of the economy. In the absence of this imperative elasticity and flexibility, the imbalance between the needs and the means of the Union on the one hand and States on the other, which may attain sometimes quite an unmanageable proportions, will prevent harmonization of different welfare and developmental activities of the different authorities. The resultant disequilibrium may seriously jeopardise the whole process of accelerated rate of economic growth with progressive reduction of regional disparities.

All this points out to the need that the allocation of the sources of revenue between the Union and the State governments should be such as : (a) to provide the Union authorities with adequate funds to meet its normal requirements together with an adequate reserve powers to meet sudden and unforeseen contingencies; (b) to provide the State governments with funds for normal expenditure with additional and increasing funds for the normal growth in the nation building services (e.g., education, public health, community development, agriculture, industries, etc.) for which the latter are generally responsible; and (c) to provide for alterations in the light of experience and in changing circumstances, i.e., the financial framework must be elastic and flexible enough to allow for the emerging situations.

The Principles of Equity and of Transference

Inequitable treatment of the citizens according to place of residence has developed into an outstanding problem of federalism, more so in the underdeveloped economies where the regional economic imbalances are more pronounced than those in the relatively developed economies. In a federal set-up, the revenue raising authorities are multitudinous and quite often their attempt to raise revenues from a common base leads to different and discriminating rates and basis. Discriminating and unequal taxes on commodities, business and industrial undertakings, levied by different revenue raising authorities may not imply, necessarily, unequal and impairing burden, but quite often they do create a fiscal illusion which may lead to locational changes in industry and trade to the detriment of a balanced regional growth of the federal economy. As regards federal taxes, each unit of federation should contribute towards common *burdens* on an equal basis. This principle may be found difficult in practice. The taxable capacity of each unit may not necessarily be the same and equality of *contributions* may mean an undue burden on backward States as compared with more advanced ones. Equity of burden should, therefore, as far as possible, be one of the fundamental tenets of the federal finance.

Allied to the principle of equity is the principle of transference, which means that in order to reduce inter-State and inter-regional disparities in the levels of economic development, the machinery of public finance, through a judicious policy of transference from the relatively more developed areas to the relatively less developed areas in a federal State, can quite effectively be used. It must be remembered that existence and perpetuation of vast inequalities in the relative economic status of different States is not at all conducive to the balanced regional growth of the economy. Quite logically, it becomes the primary function of the Union government to undertake measures to fill up the gaps of economic unevenness between the States caused by historical factors, differences in the natural resources and their development, population pressures, lack of capital resources and the entrepreneurial availability, etc. Apart from social and political considerations, such economic reasons for the Union government to discriminate between the various States in terms of transference would, therefore, be clear and legitimate.

Economy in Costs

Economy can and must be effected in all directions, since in its absence, fiscal burdens are increased and benefits reduced. In other words, the fiscal system loses efficiency and the transfers originating in it, instead of causing more productive use of less productive resources, reverse the process, which is reflected in rising costs. Similar results follow from lack of coordination of the fiscal programmes and measures of various governments in a federation. Collection of a given amount with the least possible burden on the national income; absence of overlapping in the fiscal programmes of various governments; absence of faulty allocations; expansionist impact upon the economic growth resulting from judicious use of resources made possible by coordinated, integrated and harmonious inter-governmental fiscal policies, are expected to satisfy broadly the canon of economy which is an essential factor of good finance.

Need of an Overall Flexibility

Adherence to the norms of federal finance requires independent scrutiny from time to time, and a re-adjustment of fiscal relationship according to circumstances. Whether the problem is viewed from the point of adequacy and elasticity or we examine it from the point of view of equity, efficiency and economy, flexibility seems to be the basic factor in a rational system of federal finance.

The need for such a flexibility arises from certain basic factors. *Firstly*, the yields from the same sources of revenue, because of unevenness of economic development,institutional disparities and varying administrative efficiency, would vary from State to State. Financial powers do not connote the actual quantitative size of the revenue which can be collected by the respective authorities in a federal financial system, but only the extent of the power which determines the means through which they can collect the required revenues. *Secondly*, in a growing economy, because of the very nature of the functions normally falling within the jurisdiction of the States, their expenditures expand considerably with the process of economic development. But their revenues do not show an equivalent buoyancy because their sources of revenue are usually inelastic. This naturally creates an increasing gap between their financial commitments on the one hand and revenues on the other. *Thirdly*, the financial needs of each State, because of certain historical, social, economic and institutional factors, vary quite considerably. There must, therefore, be some 'balancing factors' in the scheme of allocation of sources of revenues, in order to correct inter-State imbalances arising out of the aforesaid factors and to introduce an element of greater elasticity to the revenues of the States. In short, certain resources should be transferred from the Union to the States and the system of such transfer should be flexible so as to suit the changing character of the problems of federal finance. "Every system of government should continuously adapt itself to the changing needs and circumstances of the society whose interests it has to safeguard and promote. There must always be a certain amount of dynamism about it. Static systems lose all vitality. The dynamism that should characterise the federal system of government is of a special variety. It consists in a fresh redistribution of powers between the Centre and the units as demanded by the changing needs of the society."[4] In order that

[4]Venkatarangaiah, M., *Competitive and Cooperative Trends in Federalism*, R. R. Kale Mamorial Lecture. Poona : Gokhale Institute of Politics and Economics, 1951, p. 17.

such flexibility might not harbour on uncertainty it becomes imperative to have an independent commission to regulate such changes.

3

The Methods of Distribution of Sources of Revenue

The methods of distribution of powers of taxation among the Union and the State authorities are entirely distinct and separate from the problem of the distribution of yield from taxation. It is rightly pointed out that the financial sovereignty of the constituent units of a federation embraces two distinct elements : (a) the sovereign power of taxation; and (b) the right to the yield of taxation. The problem of federal finance, therefore, reduces itself into two clear and distinct issues : (1) how is the power of taxation shared between the Union and the State authorities; and (2) how are the proceeds of a tax, whether imposed by the Union authorities or the State authorities, to be distributed as between the Union and the States, and if so, on what criteria ? To these two must be added a third important question : does the Union grant any aid(s) to the States *or* do the States make any contribution to the Union exchequer ? Each system of federal finance has to be approached with a view to assess the solutions offered to these three problems.

Division of the Powers of Taxation

Although there is a larger variety of methods of the division of the taxing powers between the Union authorities on the one hand and the constituent units on the other, they are all variants of three basic methods. *Firstly*, the Union authorities may impose all the taxes and levies to raise all the moneys needed, and then to pass on to the State authorities a part of it. *Alternatively*, the States' authorities may impose all the taxes and levies or even to borrow funds and then to transfer a part of it to the Union authorities. *Thirdly*, the Union and the States may each have their separate spheres of taxation and levies, insulated and exclusive, or concurrent. This division may take either of the two forms. In the *first* place specified fields are put within the exclusive competence of the Union authorities, while residuary fields lie entirely within the jurisdiction of the constituent units.[5] In the *second* place the constituent States are granted exclusive powers to impose taxes in particular fields

[5]An interesting illustration conforming to this type of division is the Constitution of Switzerland which contains an express enumeration of matters falling within the sphere of the Confedration. Another instance of such a distribution is given by the Constitution of Argentina.

while all the remaining or potential sources are put under the jurisdiction of the Union authorities.[6] *Fourthly,* the system of concurrent powers permits the Union authorities as well as the constituent units to impose taxes and levies in relation to the same subject matters.[7] Thus, in the last case *either* both the Union and the State governments might be permitted to levy all kinds of taxes *or* the sources of revenue might be divided between them *or* certain sources of revenue may be exclusive for the two and certain others may be on the concurrent list. When both the Union and the State authorities have the right to tax people—whether the taxes are the same or quite different—they might either be allowed to appropriate and use the revenue raised by them, or the funds so raised may be pooled together and then divided between them according to their needs. Or, again, they may be allowed to retain what they have raised, but one government may be required to give a part of its revenues to the other.

All these methods of obtaining funds for the various governments are not equally efficient and desirable because one method may be good from one point of view while another may be so from another view point. There is no federal Constitution, either existent or defunct, in which the first or the second method of division of powers of taxation has been completely adopted.[8] The most desirable scheme involving division of the powers of taxation is that the sources of revenue assigned to the Union and the State authorities should follow generally the same broad pattern as the functions on which they have to incur expenditure. Thus those taxes that are likely to have an effect on the economic life of the country as a whole, irrespective of the area from which they are realised, must obviously be levied by the Union. On the other hand, taxes which have no effect in States other than the ones from which they are collected are generally assigned to the States.

This system of separation of resources has some natural advantages. Each government, whether Central or State, can be self-sufficient and is enabled to adjust its fiscal system to its own fiscal needs. The financial independence of each government enables it to discharge its functions efficiently, fully and unhampered. In practice, however, this separation of resources cannot be pushed very far. There are two main reasons for this. *Firstly,* the line of demarcation between sources of taxation which are suitable for the Union and those which are suitable for the States cannot always be sharply and clearly drawn. *Secondly,* and this is even

[6]An illustration of this kind of distribution of taxing powers is given by the Constitutions of Burma and Canada.

[7]A typical example in point is to be found in the Constitution of Mexico.

[8]Sen, Sirdar D.K., *A Comparative Study of the Indian Constitution,* Volume I. Calcutta : Orient Longmans, 1960, p. 236.

more fundamental difficulty, inspite of the greatest care and foresightedness that may be exercised, a complete separation of resources is likely to bring in financial difficulties. It may, for instance, happen that the particular sources of revenue assigned to a government may either be inadequate for its needs or may exceed its requirements. *Thirdly*, in a developing economy, the separation of sources of revenue between the Union and the States which seems to conform ideally today, may not be adequate and sufficiently exclusive after sometime depending upon the changed needs and circumstances. For all the aforesaid difficulties, a need arises for provision of further financial adjustments.

The Financial Adjustments

In a federal set-up, the principle of matching means with needs may not be workable quite adequately in any of the schemes discussed above which may be adopted. This points out to the need for some sort of financial adjustments as between the Union and the constituent units in order to even out the respective financial deficits or surpluses of the two sets of authorities. In order to solve this problem, a number of alternatives are suggested. *Firstly*, the entire receipts of taxes may be divided between the Union and the State governments according to some set arrangement. *Secondly*, in order to make up the financial needs, additional taxes may be imposed by the Union government on the existing State taxes, *or*, additional taxes may be imposed by the State governments on existing Union taxes. *Thirdly*, the States may contribute to the financial deficits of the Union government *or* the Union government may contribute to the deficits of the States by sharing the revenues of certain taxes and levies supplemented by a system of well defined grants-in-aid.

None of the various possible methods of allocation of resources among the federal and the State governments and adjustments mentioned above is completely satisfactory. Nevertheless, one or another of them, or some combination of two or more of them, has to be resorted to. In practice, the methods that have proved to be most workable are to have, in the first place, as clear cut a distinction between the Union and the State sources, as possible, but allocating relatively more productive and elastic sources to the Union authorities and relatively less productive and elastic sources to the State authorities; in the second place, to fill up gaps and inequalities by a further division of the proceeds of large taxes falling within the jurisdiction of the Union authorities; and, in the third place, to a slightly small extent, by the Union grants to the States for both general and specific purposes.

4

Distribution of the Sources of Revenue in India

No other federal Constitution makes such elaborate and comprehensive provisions as the Constitution of India with respect to the Union-State financial relationship. "The financial provisions of the Indian Constitution clearly show that the Constitution follows primarily the principle of rigid separation in the matter of distribution of taxing powers between the Union and the member States. The two fiscal spheres are distinct from each other; whatever the Constitution allots to the States is withdrawn from the hands of the Union; on the other hand, the States are not entitled to encroach on any fiscal matter which the Constitution has not particularly assigned to them. For all matters not specifically earmarked for the States by the Constitution fall exclusively within the sphere of the Union."[9]

The salient features of the allocation of resources are that the Indian Constitution provides : (1) as clear cut a distinction as possible between the sources of the revenues of the Union and the States enumerated in the Lists I and II of the Seventh Schedule of the Constitution; (2) taxes which shall be levied and collected by the Union, but the proceeds will be shared between the Union and the States (Articles 270 and 272); (3) taxes which shall be levied and collected by the Union, but the entire proceeds shall be assigned to the States (Article 269); and (4) taxes which shall be levied by the Union but shall be collected and appropriated by the States. It has been provided that all revenues of the Union government shall form the Consolidated Fund of India, and similarly all revenues of each State shall form the Consolidated Fund of the State.

The respective sources of revenue for the Union and the States, as provided in the Indian Constitution, are detailed below :

A. Sources of the Union Government

The *principle* sources of revenue falling within the jurisdiction of the Union authorities are:

Corporation tax

Currency, coinage and legal tender; foreign exchange

Duties of customs including export duties

Duties of excise on tobacco and certain goods manufactured or produced in India

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[9] *Ibid.*, p. 240.

Estate duty in respect of property other than agricultural land

Fees in respect of any of the matters in the Union List, but not including any fees taken in any Court

Foreign Loans

Lotteries organised by the Government of India or the Government of a State

Post Office Savings Bank

Posts and Telegraphs; Telephones, Wireless, Broadcasting and other like forms of communication

Property of the Union

Public Debt of the Union

Railways

Rates of stamp duty in respect of Bills of Exchange, Cheques, Prommissory Notes, etc.

Reserve Bank of India

Taxes on income other than agricultural income

Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies

Taxes other than stamp duties on transactions in stock exchanges and future markets

Taxes on the sale or purchase of newspapers and on advertisements published therein

Terminal taxes on goods or passengers, carried by Railways, sea or air

B. *Sources of the State Governments*

The constitution provides for the following *main* sources of revenue to be levied and the proceeds to be collected by the States :

Capitation taxes

Duties in respect of succession to agricultural land

Duties of excise on certain goods produced or manufactured in the States, such as, alcoholic liquids, opium, etc.

Estate duty in respect of agricultural land

Fee in respect of any of the matters in the State List but not including fees taken in any Court

Land revenue

Rates of stamp duty in respect of documents other than those specified in the Union List

Taxes on agricultural income

Taxes on land and buildings

Taxes on mineral rights, subject to limitations imposed by Parliament relating to mineral development

Taxes on the consumption or sale of electricity

Taxes on the entry of goods into a local area for consumption, use or sale therein

Taxes on the sale and purchase of goods other than newspapers

Taxes on advertisements other than those published in newspapers

Taxes on goods and passengers carried by road or on inland waterways

Taxes on vehicles

Taxes on animals and boats

Taxes on professions, trades, callings and employments

Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling

Tolls

C. Taxes Levied and Collected by the Union but distributed among the Union and the States

Net proceeds of the following taxes which are levied by the Union government are distributed between the Union authorities and the States:

Taxes on income other than agricultural income (Article 270)

Union duties of excise other than such duties of excise on medicinal and toilet preparations as are mentioned in the Union List and collected by the Government of India (Article 272)

'Taxes on income' does not include corporation tax. The distribution of the proceeds of taxes on income (other than agricultural income) and the Union duties of excise as defined above between the Union and the States is made on the basis of the recommendations of the Finance Commission. A convention has developed in this respect that the President asks the Finance Commission, *firstly*, to recommend the share of the net proceeds of these taxes as are assignable to the States, and *secondly*, to recommend the share of different States in the amounts assigned to the States alongwith the principles on which such shares are based as well as those for the proceeds of taxes listed under D below.

D. Taxes Levied and Collected by the Union but the Proceeds Assigned to the States

Article 269 (1) of the Constitution provides that the following duties and taxes shall be levied and collected by the Union government but shall be assigned to the States in the manner provided in the Article 269 (2). It provides that the net proceeds in any financial year of any such duty or tax, except in so far as these proceeds represent proceeds attributable to Union Territories shall not form part of the Consolidated Fund of India, but shall be assigned to the States within which the duty or tax is leviable in that year, and shall be distributed among those States in accordance with such principles of distribution as may be formulated by Parliament by law. Article 269 (3) provides further that Parliament may by law formulate principles when a sale or purchase of goods takes place in the course of inter-State trade or commerce.

Duties in respect of succession to property other than agricultural land

Estate duty in respect of property other than agricultural land

Taxes on railway fares and freights

Taxes other than stamp duties on transactions in stock exchanges and future markets

Taxes on the sale or purchase of newspapers and on advertisements published therein

Terminal taxes on goods or passengers carried by railway, sea or air

Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce

E. Taxes Levied by the Union but Collected and Proceeds Appropriated by the States

Stamp duties and duties of excise on medicinal and toilet preparations as are mentioned in the Union List shall be levied by the Government of India but shall be collected :

(a) in the case where such duties are leviable within any Union Territory, by the Government of India; and

(b) in other cases, by the States within which such duties are respectively leviable (Article 268)

In spite of Articles 269 and 270 which provide for the collection of taxes by the Union either to be assigned to the States or to be shared between the Union and the States, Parliament is, under Article 271, authorized to impose a surcharge for the purposes of the Union on all the items of tax included in Articles 269 and 270. The entire proceeds of such a surcharge will form part of the Consolidated Fund of India.

Taxes on Professions, Trades, etc.

Although the imposition and collection of income tax are within the jurisdiction of the Union, the States are permitted to impose a tax on professions, trades, callings or employments. Such a tax will not be invalid on the ground that it relates to a tax on income. Taxes on professions, etc., are generally made use of for the benefit of local self-governing institutions such as municipalities, local boards, etc. If such a tax were not allowed, an important source of income of these bodies would have come to an end, adversely affecting their already depleted sources of income. There is, however, an upper limit of Rs. 250 per annum prescribed for this tax.

The nature and distribution of functions and the sources of revenue between the Union authorities and the States, as embodied in the Constitution, and their operations in practice since 1950, have demonstrated beyond doubt that the system has favoured the Union with elastic and more productive sources of revenue as against the States, although the functions of the latter are elastic in expansibility and the resultant expenditure, and the sources of their revenues are relatively less elastic and not very productive. The constitutional device in order to balance the financial resources of the Union and the States is the provisions of Articles 269, 270, 272, 275 and 282, and the statutory provisions for the appointment of a Finance Commission under Article 280 for quinquennial review and recommendations in respect of transfer of resources from the Union to the States. In chapter 2, therefore, the final recommendations of the four Finance Commissions, and the interim recommendations of the fifth Finance Commission, so far reported, are examined with a view to find out as to how far the system has been able to face the stresses and strains of the developing economy with a federal financial set-up.

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2

The Finance Commission

Broadly speaking, the general rule of federal constitutions is that the proceeds of a tax is to be appropriated by the authority which imposes it. Thus, if the Union authorities impose a tax in respect of a source assigned to its competence, they retain the proceeds accruing from such a tax. Similarly, the proceeds of a tax imposed by the constituent units would be appropriated by them. Notwithstanding all this, "a chronic gap between the own resources and expenditure potential of the States seems to be an inherent feature of all well-established federations. Since in the fast-changing circumstances the extent of the gap varies from time to time, the devices or at any rate, the majority of them, have to be necessarily flexible. It is worthwhile having definite provisions and providing a mechanism for their periodical review rather than trust to their being changed when they are proved grossly inadequate, and out of date."[1] The framers of the Indian Constitution, having taken into account the imperative need for flexibility in balancing devices and mindful of the inconveniences to which other federations were put due to the rigidity of the provisions in their respective Constitutions, provided for a periodical revision of the arrangements by incorporation in the Constitution itself. Moreover, "the general weakness of the federal-State financial relations, more particularly in the field of devolution, is that federal assistance tends to be discretionary in character, not necessarily on the principles of uniform application. The Constitution provides, therefore, that the

[1]Lakdawala, D.T., *Union-State Financial Relations*. Bombay : Lalvani Publishing House, 1967, p. 45.

assessment of the needs of the States as well as the measure of assistance to be afforded and the form in which it should be given, are determined by an independent Commission to be constituted at intervals of not more than five years."[2]

Accordingly, the Constitution incorporates four types of balancing factors. *Firstly*, income tax, other than the agricultural income tax, is imposed and collected by the Union government, but the net proceeds are to be distributed between the Union and the States. Similarly, excise duties which are imposed and realised by the Union government are also distributable among the Union and the States. The Constitution provides that a percentage of the net proceeds of these two types of levies, as may be determined by the President, on the recommendations of the Finance Commission, be allocated to the States. The reason for assigning the taxing power to the Union government arose from the desirability of the uniformity of legislation throughout the Union. Moreover, these taxes are essentially central in character, being capable of satisfying the principles of efficiency and economy in collection only if they are levied and collected by the central authorites. Resources transferred to the States under these two categories of Union revenues form by for the most important method of devolution. *Secondly*, the proceeds of certain taxes, although they are levied and collected by the Union government, are assigned to the States. Here again, the reason for assigning the taxing power to the Union is the desirability of uniformity and efficiency and economy in collection. These taxes are enumerated in the Article 269. *Thirdly*, certain taxes are levied by the Union, but the proceeds are collected and appropriated by the State governments for their respective areas. Such taxes are enumerated in Article 268. *Fourthly*, there is a provision for the Central grants-in-aid of the States' revenue that are decided after taking into account the recommendations of the Finance Commission in this respect. Such grants are recommended in terms of the provisions of Article 275. In the present chapter, we shall deal primarily with the first and the fourth provision, particularly the role of Finance Commission in this respect.

'Finance Commission' means a Finance Commission constituted under Article 280 of the Constitution which runs as follows:

"(i) 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.

[2]*Report of the Third Finance Commission*. New Delhi, 1961, pp. 34-35.

(ii) The Parliament may by law determine the qualifications which shall be requisite for appointment as members of the Commission and the manner in which they shall be selected.

(iii) 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 and the allocation between the States of the respective shares of such proceeds;

(b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India; and

(c) any other matter referred to the Commission by the President in the interest of sound finance.

(iv) The Commission shall determine their procedure and shall have such powers in the performance of their functions as Parliament may by law confer on them."

The *first* Finance Commission was appointed by the President in November 1951 and it submitted its report in December 1952.[3] After that four more Finance Commissions have been constituted in June 1956, December 1960, May 1964 and March 1968 respectively. The respective reports were submitted in September 1957, December 1961 and September 1965 by the *second*, *third* and *fourth* Finance Commissions respectively. The *fifth* Finance Commission is likely to submit its final report sometime in the middle of 1969.

2

The Terms of Reference

The functions of the Finance Commission as enumerated in the Articles 280 (iii) (a), (iii) (b) and (iii) (c) of the Constitution determined the terms of reference of the five Finance Commissions which have hitherto been constituted.

As regards Article 280 (iii) (a), the *first* Finance Commission were required to recommend on the distribution of net proceeds of income tax and certain Union excise duties between the Union and the States, and the

[3]For the period intervening the commencement of the Constitution and the appointment of the *first* Finance Commission, Shri C.D. Deshmukh was asked by the Government of India to enquire into and recommend on the question of the States' share in the net proceeds of income tax and the mode of its distribution among the States, and the payment of grants-in-aid under Articles 273 and 275 of the Constitution.

allocation of the States' share of such proceeds between the States. In addition to these two items, the *second* Finance Commission was requested to make recommendations regarding the distribution of net proceeds of three new heads of revenue: (a) estate duty on property other than agricultural land; (b) tax on railway fares; and (c) additional excise duties imposed by the Union in replacement of States' sales taxes on cartain commodities and allocation thereof among the States. The *third* and *fourth* Finance Commissions were asked to recommend changes, if any, to be made in the principles governing the distribution of the net proceeds of these taxes and duties excepting tax on railway fares.[4]

As for Article 280 (iii) (b), all the four Finance Commissions were charged for evolving the principles governing the grants-in-aid of the revenues of the States out of the Consolidated Fund of India.

The *first* Finance Commission was to recommend on: (a) the sums as grants-in-aid of the revenues of the States of Assam, Bihar, Orissa and West Bengal in lieu of assignments of any share of the net proceeds in each year of the export duty on jute and jute manufactures in accordance with the provisions of Article 273 of the Constitution[5], and (b) the States in need of financial assistance and the amounts payable to such States as grants-in-aid of their revenues under the substantive portion of Article 275(1) of the Constitution.

The *second* Finance Commission was also to recommend on the quantum of grants-in-aid of the States' revenues payable under Articles 273 and 275(1), but the Commission was to take into consideration, in addition to this, the requirements of the Second Five Year Plan, and also the efforts made by the States to raise additional revenues from the sources available to them.

The *third* Finance Commission was not to recommend grants under Article 273 as the grants under this Article were stopped with effect from the financial year 1960-61. The grants-in-aid under Article 275 (1) were

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[4]By the time the *third* Finance Commission commenced its proceedings, the tax on railway fares was merged into the fares themselves and the former was repealed in April 1961. As a consequence, this item got excluded from the shareable taxes and duties and the resultant loss to the States was to be made up in terms of grants-in-aid of the revenues of the States.

[5]Under S.140(2) of the Government of India Act, 1935, certain jute producing Provinces were entitled to a share in the proceeds of export duty on jute. Under the Constitution, the States shall have no right to any such share as all export and import duties belong to the Union. But since a sudden withdrawal of this source of revenue might have created difficulties for the States concerned, Article 273 provided that for a period of ten years from the commencement of the Constitution, the jute growing States of Assam, Bihar, Orissa and West Bengal will receive grants-in-aid from the Union in lieu of the above share of jute export duties, to the extent of such sums as the President may prescribe. Article 273 has thus become defunct since 1960.

to be recommended having regard, among other considerations, to : (a) the financial requirements arising from the Third Five Year Plan; and (b) efforts to be made by the States to raise additional revenues from the sources available to them. The Commission were to recommend also the mode of distribution among the States of an ad-hoc grant of Rs. 12.5 crores payable to the States in lieu of loss arising from the abolition of tax on railway fares.

The *fourth* Finance Commission, in addition to making recommendations for the distribution of ad-hoc grant of Rs. 12.5 crores, were to recommend the amounts of grants-in-aid of the revenues of the States under Article 275(1) having regard, among other considerations, to : (a) the likely resource position of the States for the five year period ending with the financial year 1970-71 on the basis of the level of taxation likely to be reached in the financial year 1965–66; (b) the requirements of the States to meet the committed expenditure on the maintenance and upkeep of plan schemes completed during the Third Five Year Plan period; (c) any further expenditures likely to devolve upon the States for servicing the States' debts; (d) creation of a fund out of the excess, if any, over a limit to be specified by the Commission, of the net proceeds of estate duty on property other than agricultural land accruing to the States in any financial year, for the repayment of States' debts to the Union government; and (e) the scope of the economy and the efficiency which may be affected by the States in their administrative expenditures.

As for Article 280 (iii) (c), the *second* Finance Commission was to recommend in regard to modifications, if any, in the rates of interest chargeable on and the terms of repayment of the loans given to the various States by the Union government between August 15, 1947 and March 31, 1956. The *fourth* Finance Commission was to enquire into the effects of combined incidence of the States' sales taxes and Union excise duties on the production, consumption and export of commodities, the duties on which are shareable with the States, and the adjustments, if any, to be made in the States' share of Union excise duties if there is any increase in the States' sales taxes on such commodities over a limit to be specified by the commission.

The recommendations of the *first* Finance Commission were to be effective for a period of five years, 1952-53 to 1956-57; those of the *second* for another five years, 1957-58 to 1961-62; those of the *third* were to cover only four years, 1962-63 to 1965-66; and those of the *fourth* were for a further period of five years, 1966-67 to 1970-71.

3

Recommendations on Taxes and Duties

From the terms of reference of the Finance Commission as detailed in the perceding paragraphs, the recommendations of the *first*, *second*, *third* and *fourth* Finance Commissions can broadly be discussed under two heads, viz., (1) the distribution of various taxes and duties among the Union and the States, and the allocation among the States of the share accruing to them; and (2) grants-in-aid of the revenues of the States. The proceeds of the taxes and duties which are distributable among the Union and the States under the recommendations of the Finance Commission are income tax, Union excise duties, additional excise duties, estate duty, and the tax on railway fares.

Income Tax

The *first* Finance Commission recommended that 2.75 per cent of the net proceeds of income tax (i.e., net of tax attributable to the central emoluments, central surcharge, and cost of collection) would be attributable to Part C States.[6] Of the remaining amount, 55 per cent was to be assigned to Part A and Part B States (excluding the State of Jammu and Kashmir). The Commission further recommended that 80 per cent of the States' share of the divisible pool should be distributed among the States on the basis of their relative population and 20 per cent on the basis of collection.[7]

The *second* Finance Commission, in its final report[8], recommended that one per cent of the net proceeds of income tax should be assigned to the Union Territories. Of the balance, 60 per cent was to be attributable to the States. Thus the States' share in the divisible pool was in-

[6]With the linguistic reorganisation of the States, the special categories of States as Part A, Part B and Part C were abolished in 1956.

[7]The basis suggested to the Commission, however, were: (a) the collection of income tax in various States; (b) the amount of income tax realized in respect of incomes, wherever earned, of individual residents in different States; (c) the collection of income tax in various States adjusted with reference to origin of income; (d) the relative population of each State; (e) the relative volume of industrial labour in each State; (f) the relative per capita income of the States; and (g) the needs of the different States according to various criteria, such as area or sparseness of population, economic backwardness or the inverse relative *per capita* income of each State.

[8]The Commission submitted an interim report in November 1956 to facilitate transfer of resources from the Union to the States pending submission of the final report.

creased from 55 percent, as recommended by the *first* Finance Commission, to 60 per cent. The *second* Finance Commission held the view that the share of the States should be distributed among them on the basis of population alone. The 'collection criteria' was to be eliminated, however, by stages, and as such the Commission recommended that the allocation of States' share among them should be 90 per cent on the basis of population and 10 per cent based upon 'collection criteria'. "This should make it easy to complete, in due course, the process of eliminating the factor of collection altogether and distributing the entire amount of the States' share on the basis of population."[9]

The *third* Finance Commission recommended[10] : (1) an increase in the net proceeds of income tax attributable to Union Territories from one per cent to 2.5 per cent; and (2) an increase in the share of States from 60 per cent to 66 2/3 per cent of the remaining distributable pool. As for the allocation of States' share among them, the *third* Finance Commission felt that 'population criteria' should, no doubt, remain the main allocational factor, but due weightage should also be given to the 'contribution criteria' in view of: (a) the exclusion from the divisible pool of taxes on income paid by the companies; and (b) the higher expenditure on administrative and social services of relatively industrially advanced States contributing larger share to the income tax pool. Accordingly, the Commission recommended the allocation of States' share among them in terms of 80 per cent on the basis of population and 20 per cent on the basis of collection—incidently, restoring the formula recommended by the *first* Finance Commission.

By the time the *fourth* Finance Commission was constituted the feeling grew that exclusion of company income tax from the income tax had resulted in a diminished rate of growth of the divisible pool. The proceeds from the corporation tax were increasing at a much faster rate than that of the income tax. The Commission rightly pointed out that, "while the collections from corporation tax have increased by well over 600 per cent in the course of the last 12 years, the corresponding growth in the divisible pool of income tax was less than 50 per cent."[11] Further, by levy

[9]*Report of the Second Finance Commission*. New Delhi, 1957, p. 40.

[10]The Finance Act, 1959 provided for a change in the structure of corporate taxation which resulted in the conversion of company income tax into corporate tax. As the corporate tax does not form a part of the divisible pool, the conversion was likely to shrink the pool considerably and hence the share attributable to the States. The States were assured, however, that pending the examination of the matter by the *third* Finance Commission, the States were to continue getting their share of income tax approximately the same amount which they would have got had this change not been affected. The recommendations of the *third* Finance Commission took into account this material change.

[11]*Report of the Fourth Finance Commission*. New Delhi, 1965, p. 17.

of surcharge, the Union were in a position to command a still larger share of the tax yield. In the light of this development the Commission recommended that 2.5 per cent of the net proceeds of income tax should be attributable to the Union Territories and of the balance 75 per cent was to be allocated to the States. As regards the mode of distribution of the States' share among them, it was recommended that 80 per cent of the share may be distributed on 'population criteria' and 20 per cent on the 'collection criteria'.

Union Excise Duties

The distribution of the proceeds of the Union excise duties is governed by Article 272 of the Constitution. The Article, however, makes no specific provision and it was left to the Parliament to decide whether the proceeds of any of these duties is to be shared with the States, and if so, to what extent. Prior to April 1, 1952, proceeds of none of the Union excise duties were shared between the Union and the States. The question of sharing the proceeds of the Union excise duties was not, in fact, before the *first* Finance Commission in the initial stages. It was only when the Commission's discussions with the State governments progressed that they were convinced about the need to augment the States' financial resources, and as such they took up the matter of distribution of Union excise duties between the Union and the States. Thus, the *first* Finance Commission selected three Union excise duties, e.g., duties on tobacco (including cigarettes, cigars, etc.), matches and vegetable products, for division on the ground that these commodities were of common use and of widespread consumption and also yielded a sizeable and reasonably stable revenue for distribution. The Commission recommended that 40 per cent of the net proceeds of these duties be distributed among Part A and Part B States (except the State of Jammu & Kashmir)[12] starting from the financial year 1952-53. In order to make the scheme of distribution balanced and equitable, the Commission found the 'per capita criterion' as the most appropriate one and as such recommended that the States' share of excise duties be distributed among them on the basis of population according to 1951 census. On the suggestion from some States that relative consumption of the taxed commodity should form the basis of distribution, the Commission observed : "that basis cannot at present be considered as there are no reliable data regarding the consump-

[12]The State of Jammu and Kashmir was financially integrated in the Indian Union in April 1954. Under an agreement, a sum equivalent to 40 per cent of the net proceeds of the Union excise duties levied and collected by the Union government in the State of Jammu and Kashmir were paid to the latter till 1st April, 1957, when this State was also included in the scheme of distribution.

tion of each of the commodities in the various States." It was recommended, however, that "steps should be taken to collect and maintain statistics of the consumption of all major commodities that may be subject to Union excise from time to time, so that the data may be available to the Commission in future."[13]

By the time the *second* Finance Commission was constituted the coverage of Union excise duties had increased considerably. In 1952-53, the Union excise duties were levied on 13 commodities with a gross yield of Rs. 94 crores. By 1957-58 the levy was extended to 32 commodities and it produced a gross yield of Rs. 274 crores. The *second* Finance Commission had, therefore, a broader view of the entire problem and felt that the States deserved a larger share of the proceeds of Union excise duties. Accordingly, the Commission recommended that the distributable pool should be expanded to include Union excise duties on sugar, tea, coffee, paper and vegetable non-essential oils making them eight commodities in all. It was recommended further that the States' share of the net proceeds of the Union excise duties be reduced to 25 per cent. The reduction in the percentage was more than compensated by the expanded number of duties added to the distributable pool. Although the scheme of devolution recommended by the *second* Finance Commission was to enlarge considerably the States' share of the total proceeds of the Union excise duties, a number of States demanded that all the Union excise duties should be brought into the divisible pool; while some others wanted a further increase in the number of shareable Union excise duties. The Commission felt that, on the whole, it was preferable to continue population as the sole basis for distributing the States' share amongst them. "But the practical effect of such distribution would now be to place a few States in a more advantageous position in relation to the rest," and they "accordingly decided that 90 per cent of the States' share of the divisible Union excise duties should be distributed on the basis of population, the balance of 10 per cent being used for adjustments."[14]

The *third* Finance Commission, while reviewing the schemes of devolution, had to face two main problems. *Firstly*, the conversion of company income tax into corporate tax, as stated earlier, had removed a sizeable chunk of revenue from the 'income tax pool' reducing thereby the distributable share of the States. *Secondly*, the argument was put up by the States that the expansion of the coverage of Union excise duties and progressive increase in their rates are likely to have an adverse impact on their power to raise larger revenues from the States' sales taxes which was the only elastic source of revenue for the States.

[13]*Report of the First Finance Commission.* New Delhi, 1952, p. 82.
[14]*Report of the Second Finance Commission.* New Delhi, 1957, p. 44.

The Commission felt that the adoption of a narrow base of Union excise duties for distribution stood in the way of a steady flow of revenues to the States from the distributable pools of Union taxes and levies particularly when the States were suffering from the inadequacy of resources in relation to their commitments, both for developmental and non-developmental programmes — a process which is likely to expand considerably with the passage of time. In the Commission's view, "the inadequacy of resources that has developed in the States is attributable mainly to the planning process and this inadequacy may become more pronounced with the completion of each successive Plan for some years to come. The viability of the States could best be secured by a larger devolution of the Union excise duties and this should be effected by providing for the participation of the States, by convention, in the proceeds of all Union excises. It would give a great deal of psychological satisfaction to the States and dissipate any suspicion that the Union is pursuing a policy of excessive centralization of resources."[15] With a broader base, it was felt that the buoyancy of Union excise duties on some articles could take care of the shortfall on others and this would maintain a steady flow of assistance to the States.

The *third* Finance Commission, therefore, recommended that the States should be allowed to participate in the proceeds of all the Union excise duties levied upto 1960-61, excluding (except silk fabrics) those on which the yield was below Rs. 50 lakhs a year. The Commission excluded, however, the duty on motor spirit as it recommended the distribution of a part of the proceeds of this duty as a special purpose grant for maintenance and improvement of communications. The number of commodities subject to Union excise duties, proceeds of which were to be distributable among the Union and the States, increased, therefore, from eight to thirty five. The Commission further recommended that 20 per cent of the net proceeds collected (instead of the earlier 25 per cent) on the articles listed should be deemed to be the share of the States.[16]

In determining the mode of distribution of the States' share in the proceeds of Union excise duties among the States themselves, the *third* Finance Commission, however, made a significant departure from the criteria adopted by the first two Commissions, which favoured the consumption, and, therefore, the 'population criteria' as the basis of devolution among the States. It observed that the former two Commissions "were consi-

[15] *Report of the Third Finance Commission.* New Delhi, 1961, p. 21.

[16] By this recommendation the States stood to gain substantially. In 1961-62, the States' share of the Union excise duties, including additional excise duties, was Rs. 80.7 crores. In 1962-63, the first year of coming into force of the recommendations of the *third* Finance Commission, the States' share stepped up to Rs. 125 crores.

dering a limited range of commodities which could be classified as consumer goods; but, we propose to include, in devolution, producer goods and intermediaries also. Consumption would not, in our view, be the correct criterion to apply for distribution."[17] In view of the fact that: (a) distributable proceeds of the Union excises were no longer limited to the few commodities, and (b) there being no obligatory participation on the part of the States in the yield, the Commission, while recommending the percentage share of each State in the divisible pool, took into consideration the relative financial soundness or weakness of the States, the disparity in the level of development reached, the percentage of scheduled castes, scheduled tribes, and backward classes in the population of each State, etc., in addition to 'population criteria' which was still retained as the major factor. The scheme aimed at establishing the use of the devolution of the proceeds of Union excise duties as a balancing factor in future. "We feel that in this permissive participation, an attempt should be made to bring all the States, as far as possible, to a comparable level of financial balance."[18]

The *fourth* Finance Commission enlarged further the divisible pool by recommending the inclusion of the proceeds of all Union excise duties levied currently as also those which may be levied during the currency of their recommendations. It was recommended, therefore, that in each of the five years with effect from 1st April, 1966, an amount equal to 20 per cent of the net proceeds of the Union excise duties on all the articles, levied and collected in that particular year (excepting regulatory duties, special excises and duties and cesses earmarked for specific purposes) be allocated to the States as their share in the divisible pool. As regards the allocation of States' share among the States themselves, the factor of relative financial weakness of the State was rejected by the Commission because it was felt that this factor should be taken care of by the Union grants-in-aid of the States under Article 275 of the Constitution. The Commission retained 'population criteria' as the major factor for determining the distribution and 80 per cent weight was assigned to it. 20 per cent weight was given to the factor of relative economic backwardness.

Additional Excise Duties in lieu of Sales Tax

The Union government, in consultation with the State governments, decided in 1956-57 that an additional excise duty should be levied on mill-made textiles (cotton, rayon and artificial silk and woollen fabrics), sugar and tobacco (including manufactured tobacco) which would have replaced the sales taxes then levied by the States, and the net proceeds be

[17]*Report of the Third Finance Commission.* New Delhi, 1961, p. 22.
[18]*Ibid.*

distributed among the States, subject to the then income derived by each State being assured to it.[19] An important consideration behind the scheme was that if the tax was levied at the source of production, the chances of its evasion would be minimized and that a uniform levy at the point of production of such items of mass consumption would be desirable by all the main interests, viz., industry, trade and consumer, as it would save them from the administrative complexities involved in the collection and payment of sales tax. In terms of this decision, Additional Duties of Excise (Goods of Special Importance) Act of 1957 was enacted.[20] All forms of tobacco (including manufactured tobacco), sugar and textiles became free from States' sales tax levies and additional excise duties at prescribed uniform rates began to be levied and collected by the Union government. The proceeds were to be accounted for separately and distributed among the States in accordance with the recommendations of the Finance Commission. The *second* Finance Commission accordingly was requested to suggest the scheme of distribution of the proceeds among the States.

The *second* Finance Commission recommended that : (a) the entire net proceeds (other than those attributable to Union Territories and the State of Jammu & Kashmir) of additional excise duties on mill-made textiles, sugar and tobacco (including manufactured tobacco) should accrue to the States; (b) one per cent of the net proceeds be assigned to the Union Territories; (c) an amount equal to 1.25 per cent of the net proceeds be paid to the State of Jammu and Kashmir[21]; (d) after allowing for the shares of Union Territories and State of Jammu and Kashmir, the guaranteed amount (Rs. 32.5 crores), representing the existing income of the States on account of the sales taxes, be made the first charge on the balance; and (e) the residual sum be distributed among the States on the

[19]The rationale behind the selection of the commodities was that only those commodities should be subjected to additional excise duties in lieu of States' sales taxes which were of common and widespread consumption and yielded sizeable revenues. An added consideration was the stability of yield. Silk fabrics were included in this list in 1961-62.

[20]The Act does not state that the States shall not levy sales taxes on those commodities, but merely provides that if in any year any State levies and collects a tax on the sale or purchase of such commodities, it shall not share in the net proceeds from the additional duties of excise, unless the Union government directs otherwise through a special order.

[21]Before 1st April, 1957, the State of Jammu and Kashmir had no sales tax and as a consequence there was no question of determining the existing income of the State on this account. Nevertheless, the incidence of the additional duties had to fall as much on the subjects of that State as on the people of other States. The *second* Finance Commission felt, therefore, that the State was entitled to its share.

basis of consumption figures, using population as a corrective factor.[22]

Additional excise duty on silk fabrics in lieu of States' sales taxes was introduced in 1961-62, and the *third* Finance Commission was asked to provide for its distribution also as in the case of the other three commodities. The Commission recommended that the share of Union Territories be retained at one per cent of the net proceeds, but the share of the State of Jammu and Kashmir was to be increased from 1.25 per cent to 1.5 per cent. For other States the Commission recommended a nominal increase of Rs. .04 crores in the annual guaranteed amount of Rs. 32.5 crores. The balance of the net proceeds was to be distributed among the States partly on the basis of 'population criteria' and partly on the basis of the percentage increase in the collection of sales tax in each State since 1957-58. No indication was, however, given by the Commission as to the relative weightage to be given to these factors while recommending the percentage shares of the States in the balance of the net proceeds.

The *fourth* Finance Commission retained the share of Union Territories and the State of Jammu and Kashmir at one per cent and 1.5 per cent respectively of the net proceeds, but a sum equal to .05 per cent of the net proceeds was recommended to be attributable to the State of Nagaland.[23] Out of the remaining 97.45 per cent of the net proceeds, an annual sum of Rs. 32.54 crores, representing the guaranteed amount, was to be paid to the States in lieu of sales tax on six commodities, namely, cotton fabrics, silk fabrics, rayon or artificial silk fabrics, woollen fabrics, sugar and tobacco (including manufactured tobacco). The Commission recommended that the balance be distributed among the States on the basis of the proportion of sales tax collections in each State to the total sales tax collection in all the States taken together. It was felt that the figures for collection of all sales taxes in a State serve as a better and a more direct indicator of the contribution made by each State to the divisible surplus than the population.

Estate Duty

Article 269 of the Indian Constitution provides that the estate duty on property (other than agricultural land)[24] is to be levied and collected

[22]Population was used as a corrective factor as a substantial amount of error was found in consumption figures.

[23]The State of Nagaland was constituted by order of the President under Section 23 of the State of Nagaland Act, 1962.

[24]The estate duty on agricultural land is imposed in those States which have authorized Parliament to do so under Article 252 of the Constitution and its proceeds are passed on to the State in which they are collected, as in this case, the Government of India acts only as a collecting agency for the States.

by the Union, but the net proceeds, except in so far as they represent proceeds attributable to Union Territories, have to be assigned to the States and distributed among them in accordance with the principles formulated by the parliament by law. This duty was first levied in India in 1953. Pending parliamentary legislation, the net proceeds were being provisionally distributed in the same ratio as the States' share of the divisible pool of income tax.

The matter was referred to the *second* Finance Commission. The Commission recommended that : (a) out of the net proceeds of the estate duty in each financial year, a sum equal to one per cent thereof be retained by the Union as being the proceeds attributable to Union Territories; (b) the balance be apportioned between immovable property and other property in the ratio of the gross value of all such properties brought into assessment in that particular year; (c) the sum thus apportioned to immovable property be distributed among the States in proportion to the gross value of the assessed immovable property located in each State and brought into assessment in that year; and (d) the sum apportioned to property other than immovable property be distributed among the States in proportion to the population of each State. The scheme of distribution suggested by the Commission was to be effective from the financial year 1957-58. As regards the preceding period, the Commission recommended that the distribution already made be ratified. The collections upto March 31, 1957 amounted to Rs. 4.75 crores.

The *third* Finance Commission did not suggest any change in the principles governing the distribution of estate duty as recommended by the *second* Finance Commission excepting that the 'population criteria' was recommended to be based on 1961 census.

The *fourth* Finance Commission also retained all the recommendations of the *second* Finance Commission excepting that it allowed the Union a sum equivalent to two per cent, instead of one per cent, of the net proceeds of the estate duty as the amount attributable to Union Territories.

These Commissions were of the view that the levy and collection of the taxes and duties specified in Article 269 of the Constitution had been placed under the Union government so as to ensure uniformity of taxation and convenience of collection. They considered that although that Article did not rule out any principle of distribution, the principles to be laid down should be such as to secure for each State, as nearly as possible, the amounts which it would have itself collected if it had the power to levy and collect such tax or duty. The basis of location of the property subject to estate duty was considered by them to be the most appropriate principle of distribution. However, as this basis of location could not be applied to movable property, they felt it necessary to have some general principle of distribution for the part of proceeds of the duty relating to such property; and for this purpose they adopted the 'population criteria'.

Tax on Railway Fares

Under Article 269 of the Indian Constitution, taxes on railway fares and freights are to be levied and collected by the Union, but the net proceeds, except the proceeds attributable to the Union Territories, have to be assigned to the States and distributed among them in accordance with the principles formulated by a law of Parliament. As a tax on railway passenger fares was imposed under the Railway Passenger Fares Act 1957, the *second* Finance Commission was required to make recommendations as to the principles which should guide the distribution, among the States, of the net proceeds in any financial year of a tax on railway fares.

The *second* Finance Commission recommended that .25 per cent of the net proceeds of the tax on railway fares be retained by the Union as proceeds attributable to the Union Territories. The balance of the net proceeds was to be distributed among the States, as far as possible, on the basis of the net proceeds of actual passenger travel on railways within the limits of each State. As the correct data on State-wise passenger travel was not available, the Commission gave rough estimates, therefore, of State-wise passenger travel for the purpose of distribution. In working out a formula, the Commission thought that, "if the earnings of each zonal railway are allocated by route mileage located in each State separately for each gauge, this would give, as nearly as possible, an allocation of passenger travel in terms of passenger earnings. The distribution of the tax in the ratio of the earnings thus allotted will give to each State a share that will approximate closely to the actual passenger travel in it."[25]

The tax on railway passenger fares did not, however, last long and shortly after the constitution of the *third* Finance Commission, the Union government decided to absorb the tax in the basic fares from April 1961. The Government of India, however, agreed to make an *ad-hoc* grant of Rs. 12.5 crores per annum to the States in lieu of the tax for a period of five years effective from the year 1961–62. This grant, the *third* Finance Commission recommended, be distributed to the States "on the principle of compensation to place the States broadly on the same footing as before."

The amount of the grant had been increased to Rs. 16.25 crores per annum from the year 1966-67 and is being distributed among the States according to percentage shares recommended by the *fourth* Finance

[25]*Report of the Second Finance Commission*. New Delhi, 1957, pp. 64-65,

Commission. These had been worked out by allocating among the States the passenger earnings of each railway zone (exclusive of earnings of suburban services) on the basis of the route length of railway located in each State separately for each gauge, on the basis of the statistics for the three years ending March 1964.

4

Recommendations on Grants-in-Aid

Union grants-in-aid to the States have been necessary in almost all countries having a federal set-up, for the simple reason that no system of distribution of financial resources between the Union and the States can possibly meet the needs of natural development and social services which are usually the responsibility of the States. While the more productive and elastic sources of revenue have to be concentrated with the Union in order to provide for the prime contingency of national development, the resources of the States are augmented by grants made by the Union according to the various needs of the States.

Tax-Sharing and Grants-in-Aid

Tax-sharing and grants-in-aid are the devices of transferring funds, usually from the Union to the States in a federation. Such transfer of funds may be statutory or discretionary. If the transfer is statutory, the States may claim the funds as a matter of right, although some conditions may normally be attached even to statutory transfers. Transfers which are discretionary depend generally on the discretion of the transferring Union authority. Tax-sharing and the grants-in-aid differ, however, in certain basic aspects. *Firstly*, tax-sharing usually involve a certain percentage of the proceeds of some specified taxes, levied and collected by the Union, to be transferred to the States. As such the quantum of amount so transferred depend upon the yield of such specific taxes. The amount of grants-in-aid does not depend, however, on the proceeds of certain specific taxes, but rather on the entire revenue position of the Union. The chances of fluctuations in the amount transferred from the Union to the States are, therefore, relatively more in tax-sharing than in grants-in-aid, because there is more possibility of fluctuation in particular tax or taxes than in the revenues as a whole. *Secondly*, looking from the objectives of an accelerated rate of economic growth through the process of economic planning, aiming also at reducing regional economic disparities, the device of grants-in-aid seems to be more suitable than a scheme of tax-sharing. This is because, whereas the proceeds of the shared-taxes become the part of the general revenues of the States, certain amount of conditions of specificity could always be attached to the grants-in-aid in order to influence the determination of the economic policies of the States. Viewed, however, from the point of the autonomy of the constituent units, the device of tax-sharing stands on a better footing than the device of grants-in-aid.

Types of Grants-in-Aid

Broadly, the grants-in-aid from the Union to the States may fall into either of the two categories, viz., (a) general or unconditional grants, and (b) specific or conditional grants. The general or unconditional grants cover the transfer of funds from the Union to the States in order to assist the latter financially for an efficient performance of their assigned functions. The amount so transferred becomes a part of the general revenues of the State concerned and can, therefore, be used for any purpose considered appropriate. Such grants are considered unconditional because no conditions are attached while granting them.

Specific or conditional grants, on the other hand, relate to grants-in-aid meant for the performance of certain specific functions and the amount so transferred are to be applied as such only. Besides this condition, other conditions may also be attached to such grants by the transferring authority. Specific or conditional grants may further take the form of: (a) *block grants*, meant for specific but a broad purpose without further details; and (b) *matching grants*, usually made with an understanding that only a proportion of the total cost of the specific scheme-project shall be put up by the grant-giving authority provided the other proportion is met by the grant-receiving authority. In the context of economic planning, the specific or conditional grants have taken another form, i.e., development grants or plan grants. Such grants are given both in the form of block grants and matching grants.

Objectives of Grants-in-Aid

General and unconditional grants are used, in most of the federations where they are in vogue, to solve the problem of 'non correspondence', i.e., for "supplementation of State revenues generally".[26] Problems of 'non-correspondence' vary generally with the respective stages of economic development of each of the constituent unit in a federation. As such, grants-in-aid are also used aiming at reducing the regional economic imbalances. Moreover, there are sometimes certain unconditional or general grants which are made to serve some specific purposes, but even here the amount

[26]Studenski, Paul, and Baikei, E.J., "Federal Grants-in-Aid", in *National Tax Journal*, Vol. II, No. 3, September 1949, p. 198.

goes ultimately to aid the revenues of the constituent units. 'Compensatory grants'—which are made to the constituent unit(s) to compensate them for the loss of revenue arising out of transfer of some source(s) of revenue from the constituent unit(s) to the Union or to compensate them for the loss arising out of changes in the basis of tax-sharing—fall under this category.

Conditional or specific grants are decided, in most of the federations, to serve three principle purposes. *Firstly*, specific grants are made to enable certain constituent units to put up the additional financial burden arising out of undertaking some additional obligations. These obligations may be statutory, i.e., provided under the Constitution, or voluntary, undertaken in consultation with the Union government. *Secondly*, such grants are made with a specific purpose of advancing certain economic and social activities in the constituent units, which, without the Union financial help they may be unable to undertake. In India, these objectives are sought to be achieved through plan grants. *Thirdly*, such grants are also made to aid the relatively underdeveloped constituent units to enable them to improve their administrative, economic and social services so as to bring them at par with those of the relatively developed constituent units.

Grants-in-Aid in India

Union grants-in-aid to the States and the principles involved in them have always been the most difficult and controversial subject of financial relations between the Union and the States in this country. With the induction of the Constitution in 1950 and the advent of an era of planned economic development since 1951-52, the problem of grants-in-aid to the States has attained substantial amount of new dimensions. The Constitution provides for an elaborate system of both the 'general or unconditional' grants and the 'specific or conditional' grants from the Union to the States. These provisions are, as at present, contained in the Articles 275 and 282. Article 275 of the Constitution[27] provides for both 'general or unconditional grants' to 'such States as the Parliament may determine to be in need of assistance', and 'specific block grants' to a State in the form of capital or recurring sums as provided in the *first* proviso of the Article 275 (1). Besides, *second* proviso provides for the block grants to the State of Assam. The quantum of grants-in-aid made under this Article and the principles

[27]Article 275 clause (I) of the Constitution provides that "such sums as Parliament may by law provide shall be charged on the Consolidated Fund of India in each year as grants-in-aid to the revenues of such States as Parliament may determine to be in need of assistance, and different sums may be fixed for different States."

Continued on page 46

on which it is based, are determined on the recommendations of the Finance Commission. They are intended to cover the gaps on the revenue accounts of the States and ordinarily, are expected to cover the non-Plan revenue expenditure of the States. They are known as 'statutory grants'.

Further, Article 282 provides for 'specific or conditional grants' by the Union to the States and are decided on the recommendations of the Planning Commission. The Article provides that "the Union or a State may make any grants for any public purpose, notwithstanding that the purpose is not one with respect to which Parliament or the legislature of the State, as the case may be, may make laws." Grants-in-aid made under this Article, therefore, are non-statutory and are beyond the recommendations of the Finance Commission.

A review of the grants-in-aid as recommended by the *first*, *second*, *third* and *fourth* Finance Commissions, and the principles underlying such recommendations, under the provisions of Article 275, follows in the succeeding paragraphs. Grants-in-aid provided under Article 282 are reviewed in the Chapter 3.

The *first* Finance Commission, while putting up its recommendations, seemed to have been guided by the following considerations. *Firstly*, grants-in-aid of the revenues of the States should not be purely unconditional meant for strengthening the finances of those States which were suffering from budgetary deficit. *Secondly*, grants-in-aid should conform to certain principles of aid, viz., (a) budgetary needs, (b) tax effort, (c) economy in expenditure, (d) standard in social services, and (e) special obligations and broad purposes of national importance. The budgetary needs could be determined after reducing the State budgets to a comparative basis by exclusion of abnormal, unusual and non-recurring items of expenditure. The principle of tax effort was based upon the suggestion that Central assistance be related to the self-help of the State

The *first* proviso to Article 275(1) requires grants-in-aid of the revenues of a State to be made to enable the State in question to meet the cost of such schemes of development as may be undertaken by the State with the approval of the Central government for the purpose of providing the welfare of Scheduled Tribes or to raise the level of administration of the Scheduled Areas in the State to that of the rest of the areas of that State.

The *second* proviso of the Article 275(1) requires the payment of grants-in-aid of the revenues of the State of Assam, sums, capital and recurring, equivalant to : (a) the average excess of expenditure over the revenues of the State during the two years immediately preceding the commencement of the Constitution in respect of the administration of the tribal areas specified in Part A of the table appended to paragraph 20 of the Sixth Schedule; and (b) the cost of such schemes of development as may be undertaken by that State with the approval of the Government of India for raising the level of administration of the said areas to that of the administration of the rest of the areas of that State.

concerned, viz., the States that helped themselves should be helped accordingly. Further, the tax effort should not be determined in absolute terms; rather it had to be related to the tax potential which varied from State to State. Similarly, the States which used their resources more economically, beneficially and stretched them to cover larger activities should be encouraged by grants-in-aid. States with larger level of administration and social services because of lack of resources should be entitled to larger grants. Central grants should also be given to enable the States to meet their special burdens or obligations of national importance like disruption of institutional framework of a State, strains on the economy of the State due to partition or compulsions of national security, etc., falling within the States' sphere. And finally, the Commission suggested that grants-in-aid should be given for furtherance of any beneficient services of primary importance assisting less advanced States to go forward.

With these principles in view, the *first* Finance Commission recommended : (1) under Article 273 of the Constitution[28], increased grants for four jute growing States, viz., Assam, Bihar, Orissa and West Bengal, in lieu of their share in the export duty on jute and jute manufactures; and (2) grants-in-aid, of varying amounts annually, under the substantive portion of Article 275(1) to seven States, viz., Assam, Mysore, Orissa, Punjab, Saurashtra, Travancore Cochin and West Bengal for the years 1952-53 to 1956-57 amounting to an average of Rs. 5.05 crores per year. In addition special grants were recommended for eight States, viz., Bihar, Hyderabad, Madhya Bharat, Madhya Pradesh, Orissa, PEPSU, Punjab and Rajasthan for increasing facilities for primary education.

Regarding the norms which would decide the quantum of grants-in-aid, the *second* Finance Commission found the principles laid down by the *first* Finance Commission to be unexceptionable, but found that difficulties arose in their application. The Commission felt that comparative determination of budgetary needs, tax efforts, the assessment of the measure of economy effected by a State, the degree of efficiency reached in administration of a State, the financial relation which should subsist between the Union and the States in the new situation of planned economic development and other related matters needed special detailed studies by an independent Commission. However, the *second* Finance Commission was of the view that : *Firstly*, the eligibility of a State to grants-in-aid and

[28]Article 273 provided for unconditional grants to the jute growing States of Assam, Bihar, Orissa and West Bengal in lieu of assignment of any share of the net proceeds in each year of export duty on jute and jute products until the expiration of ten years from the commencement of the Constitution. The Article became inoperative in 1960.

the quantum of such aid should depend upon its fiscal need in a comprehensive sense, i.e., after taking into account the change in transformation of the State into a welfare State, the committed expenditure arising mainly out of the maintenance of the first Plan schemes, etc. In a Union, in which the Centre and the States cooperate for planned development, grants-in-aid should subserve this end. Priorities and provisions in the Plan itself should determine the fiscal needs for development for the period of the Plan. *Secondly*, the gap between the ordinary revenue of a State and its normal inescapable expenditure should, as far as possible, be met by sharing of taxes and that grants-in-aid should be the residuary form of assistance given in the form of general and unconditional grants. *Thirdly*, grants for broad purposes may also be given. While they last, they should be grants-in-aid of revenues, but the State would be under an obligation to spend the whole amount in furtherance of the broad purposes indicated. Where these purposes are provided for in a comprehensive Plan, there will be no scope for such grants.

As for the determination of fiscal needs of a State, the *first* Finance Commission had acknowledged that it should also cover the fiscal needs arising out of development programmes undertaken. The terms of reference of the *second* Finance Commission wanted them to take into account the needs arising out of the Second Plan. In order to arrive at the fiscal needs, the *second* Finance Commission first obtained the distribution of the proposed outlays between capital and revenue; then they set off against the revenue element the additional resources which the States had promised to raise to arrive at the uncovered gap. The assistance provided in the Plan itself as Union grants for specified projects (mostly under Article 282 of the Constitution) were treated as a contribution towards bridging the gap. The residue that remained were alone considered as the requirements of the Plan which were taken into account in formulating the scheme of grants-in-aid and in determining the amount to be paid to each State.

With these considerations in view and on the assumption that in a period of five years ending March 31, 1962, revenue expenditure on development of the States was to be on the same scale as provided in the Second Plan and considering the special circumstances of each State, the *second* Finance Commission recommended, under substantive provisions of Article 275(1), average unconditional grants of Rs. 37.55 crores for eleven States, namely, Andhra Pradesh, Assam, Bihar, Kerala, Madhya Pradesh, Mysore, Orissa, Punjab, Rajasthan, West Bengal, and Jammu & Kashmir. Bombay, Madras and Uttar Pradesh were excluded because the Commission felt that the shares of revenue accruing to them under the schemes of devolution proposed would enable them to meet their current as well as Plan expenditures.

The *second* Finance Commission did not make any change in the grants-in-aid under Article 273 to four States, viz., Assam, Bihar, Orissa and West Bengal in lieu of assignment of any share of the net proceeds of the export duty on jute and jute products. However, certain adjustments were made in the grants attributable to Bihar and West Bengal in view of the transfer of certain areas from Bihar to West Bengal. The annual sums prescribed to these States in each of the three financial years beginning from 1st April, 1957 were : Assam Rs. 75 lakhs, Bihar Rs. 72.31 lakhs, Orissa Rs. 15 lakhs and West Bengal Rs. 152.69 lakhs. As stated earlier, the grants under Article 273 were to cease automatically at the end of the financial year 1959-60. The *second* Finance Commission did not extend the period of these grants.[29]

The *third* Finance Commission reiterated the views of the *second* Finance Commission that a high powered independent Commission should be set up to review the future relations between the Union and the States in order to take an integrated view of the Plan and non-Plan expenditures as a whole.

In the meantime the *third* Finance Commission agreed with the general principles enunciated by the earlier Commissions. They, however, felt that 'fiscal needs' of a State should take into account not only non-Plan expenditure but also Plan expenditure because, according to them, in a planned economy it was difficult to draw distinction between Plan and non-Plan expenditure. What was classified as non-Plan expenditure was itself due to projects launched in the previous Plan periods. The surplus in non-Plan sector should, in fact be earmarked for the purpose of the Plan. Further, strict conditions of utilisation should be attached to any grants-in-aid given for activities meant to serve national purposes like power, flood control, major irrigation works, agriculture, family planning, etc. But the States should have freedom to appropriate funds from one allocation to another in respect of grants meant generally to strengthen the State sector such as grants for education, health, minor irrigation works, etc.

Keeping in view all these considerations the *third* Finance Commission recommended an annual payment of a total grants-in-aid of Rs. 110.25 crores to all the States except Maharashtra. Of this amount, Rs. 52 crores were meant for filling the revenue gap in the budgets of the States, and the balance of Rs. 58.25 crores had been recommended as grants-in-aid towards 75 per cent of the uncovered revenue component of the State Plans.[30] In making this recommendation, the Commission

[29]In fact, there was almost no yield from this source to the Centre for the reason that the export duty was suspended. Inspite of that, these States continued to receive the assistance.

[30]*Report of the Third Finance Commission.* New Delhi, 1961, pp. 31-32.

took an integrated view of the entire budget revenue of a State, whether Plan or non-Plan, in view of the fact that the Plans contained repetitive schemes of a continuing character, the expenditure on which was unavoidable and was in the nature of committed expenditure. The Commission also felt that the grants, being statutory, would assure to the States the necessary funds to cover part of the revenue component of the Plan and also give them a greater measure of autonomy and flexibility in their administration.

But in regard to this recommendation of including a part of the Plan assistance in the Commission's scheme of devolution, the Union government felt that there was no real advantage to the States in receiving assistance towards their Plan partly by way of statutory grants-in-aid on the basis of Finance Commission's recommendations and partly on the basis of annual reviews made by the Planning Commission. The Central assistance were determined after a careful assessment of the overall financial and economic situation and after making such adjustments which changing situation demanded from year to year. In government's view, therefore, it was necessary not only to review the financial position of the Centre and the States annually, but also to take an integrated view of the entire financial picture of each State both on revenue and capital accounts in relation to the State plans as a whole. Government, therefore, accepted the *third* Finance Commission's recommendations relating to grants-in-aid under Article 275 (1) in so far as these related only to non-Plan expenditure of State governments.

The grants-in-aid of the fifteen States in each of the four years, viz., 1962-63 to 1965-66, recommended by the *third* Finance Commission at Rs. 110.25 crores per year was reduced, therefore, to Rs. 61.32 crores by the Government of India.

The Commission further recommended that during the four years 1962-63 to 1965-66, an annual amount of Rs. 9 crores, being approximately 20 per cent of the proceeds of the duty on motor spirit, should be distributed among ten States, namely, Andhra Pradesh, Assam, Bihar, Gujarat, Jammu & Kashmir, Kerala, Madhya Pradesh, Mysore, Orissa and Rajasthan, as a special purpose grant for improvement of communications.

The *fourth* Finance Commission agreed with the principles laid down by the previous Commissions and found them valid except to the extent that they did not recommend the inclusion of Plan grants and special purpose grants in grants-in-aid.[31] The Commission gave the most appropriate reason for the exclusion of Plan grants from their purview. They

[31]*Report of the Fourth Finance Commission.* New Delhi, 1965, p. 47.

pointed out that the "Planning Commission has been specially constituted for advising the Government of India and the State governments in this regard. It would not be appropriate for the Finance Commission to take upon itself the task of dealing with the States' Plan expenditure."[32]

Working out the fiscal needs of the States and on that basis the grants-in-aid permissible to the various States, the Commission took into account the revenue receipts anticipated in the next five years on the basis of taxation levels in 1965-66, the requirements relating to committed expenditure during the Fourth Plan and the special considerations such as the expenditure devolving on the States for servicing of their debts (outstanding and those likely to be incurred in the Fourth Plan) as well as provision for contribution to sinking funds for public loans. The Commission found ten States to have revenue deficits aggregating to Rs. 609.45 crores for the financial years 1966-67 to 1970-71 and on that basis recommended, under Article 275 (1) of the Constitution, annual grants of Rs. 121.89 crores in each of the five financial years commencing from 1st April, 1966. The States involved were Andhra Pradesh, Assam, Jammu & Kashmir, Kerala, Madhya Pradesh, Madras, Mysore, Nagaland, Orissa and Rajasthan.

The Commission did not include in its assessment of revenue expenditure certain increases in pay scales and dearness allowance to the State governments' employees and employees of local bodies and school teachers affected by the State governments of Andhra Pradesh, Mysore and Uttar Pradesh through orders issued in July 1965. The Commission was of the view that the effect of these liabilities might also be taken into account in fixing the grants under Article 275 (1) of the Constitution. Taking the above reeommendations into account the Union government allowed increases in the grants-in-aid of the revenues of Andhra Pradesh and Mysore by Rs. 6.29 crores and Rs. 2.58 crores per annum respectively and an annual grant of Rs. 9.85 crores to Uttar Pradesh. Thus, the annual grants-in-aid to the States increased to Rs. 140.61 crores for the five year period, 1966-67 to 1970-71.

A detailed account of the resources transferred from the Union to the States, following the recommendations of the *first, second, third* and *fourth* Finance Commissions, is given in the table on page 52.

[32]*Ibid.*, p. 29.

Resources Transferred from the Union to the States under the recommendations of various Finance Commissions since 1951-52

(Rs. Crores)

	First Five Year Plan 1951-52 to 1955-56*	*Second Five Year Plan 1956-57 to 1960-61*	*Third Five Year Plan 1961-62 to 1965-66*	*1966-67 (Actuals)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)
A. Share of Taxes and Duties						
1. Income Tax	278	375	556	137	174	148
2. Union Excise Duties (basic and additional)	47	281	615	231	235	268
3. Taxes on Railway Passenger Fares	—	42	—	—	—	—
4. Estate Duty	2	13	26	5	7	7
Total A	**327**	**711**	**1197**	**373**	**416**	**423**
B. Statutory Grants						
5. Under Article 273	14	13	—	—	—	—
6. Under Substantive Provisions of Article 275(1)	27	153	290	141	141	141
7. Under the Proviso of Article 275(1)	14	34	39	12	9	10
8. Under Article 278	49	—	—	—	—	—
9. Under Sec. 74 of the State Reorganization Act	—	7	—	—	—	—
Total B	**104**	**207**	**329**	**153**	**150**	**151**
Total A+B	*431*	*918*	*1526*	*526*	*566*	*574*

*Transfers for 1951-52 relate to devolutions under C.D. Deshmukh's award.

Source : Government of India, *Explanatory Memorandum on the Budget of the Central Government* for 1967-68, pp. 107-110; and *Reserve Bank of India Bulletin*, April 1968, pp. 418-456.

5

The Fifth Finance Commission

The *fifth* Finance Commission was constituted by an Order of the President dated February 29, 1968. The Commission was required to make recommendations to the President on the following matters :

(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 Chapter I of Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;

(b) (1) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India; and

(2) the sums to be paid to the States which are in need of assistance by way of grants-in-aid of their revenues under Article 275 for purposes other than those specified in the provisos to Clause (1) of that Article and other than the requirements of the Five Year Plan, having regard, among other considerations, to

(i) the revenue resources of those States for the five years ending with the financial year 1973-74 on the basis of the levels of taxation likely to be reached at the end of the financial year 1968-69;

(ii) the requirements on revenue account of those States to meet the expenditure on administration, interest charges in respect of their debt, maintenance and upkeep of plan schemes completed by the end of 1968-69, transfer of funds to local bodies and aided institutions and other committed expenditure;

(iii) the scope for better fiscal management as also for economy consistent with efficiency which may be affected by the States in their administrative, maintenance, developmental and other expenditure.

(c) the changes, if any, to be made in the principles governing the distribution amongst the States of the grant to be made available to the States in lieu of the repealed tax on railway passenger fares;

(d) the changes, if any, to be made in the principles governing the distribution amongst the States under Article 269 of the net proceeds in any financial year of estate duty in respect of property other than agricultural land;

(e) the desirability or otherwise of maintaining the existing arrangements under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, in regard to the levy of additional duties of excise on sugar, textiles and tobacco in lieu of the States' sales taxes thereon, with or without any modifications, and the scope for extending such arrangements to other items or commodities;

(f) irrespective of the recommendation made under item (e) above, *the changes, if any, to be made in the principles governing the* distribution of the net proceeds in any financial year of the additional excise duties leviable under the 1957 Act aforesaid on each of the following commodities, namely,

(i) cotton fabrics,
(ii) silk fabrics,
(iii) woollen fabrics,
(iv) rayon or artificial silk fabrics,
(v) sugar, and
(vi) tobacco including manufactured tabacco

in replacement of the States' sales taxes formerly levied by the State Governments :

Provided that the share accruing to each State shall not be less than the revenue realised from the levy of the sales tax for the financial year 1956-57 in that State;

(g) the principles which should govern the distribution of the net proceeds of such additional items or commodities as may be recommended under item(e) above for levy of additional excise duties in lieu of the States' sales taxes thereon;

(h) the scope for raising revenue from the taxes and duties mentioned in Article 269 of the Constitution but not levied at present;

(i) the scope for raising additional revenue by the various State governments from the sources of revenue available to them; and

(j) the problem of unauthorised overdrafts of certain States with the Reserve Bank and the procedure to be observed for avoiding such overdrafts.

The Commission in making its recommendations on the various matters aforesaid was required to have regard to the resources of the Central government and the demands thereon on account of the expenditure on civil administration, defence and border security, debt servicing and other committed expenditure or liabilities.

The Commission had also been required to make an interim report by the 30th September, 1968 covering as many of the matters mentioned above as possible[33] and in particular, in respect of the financial year 1969-70 and to make its final report by the 31st July, 1969 on each of the

[33]The date for submission of the interim report was later extended to October 31, 1968.

matters mentioned above covering the period of five years commencing *from the 1st April, 1969.*

The terms of reference, it may be observed, as related to the devolution of the net proceeds of income tax and Union excise duties; allocation of additional excise duties; principles regarding the allocation of grants in lieu of tax on railway passenger fares; follow the terms that are usually expected of a Finance Commission. Indeed the terms are the same as for the earlier Finance Commissions.

Two important additions to the terms of reference relate to: (a) the documents of the Commission, and (b) the financial commitments of the Union government itself. "The work of the Finance Commissions have, hitherto, had an element of mystery and inscrutability about them, and in the absence of clear and specific reasoning, several assumptions had to be made about the items of expenditure presented by the States and accepted by the Finance Commission. Although the *fourth* Finance Commisssion was somewhat more specific and documentary than the earlier Commissions in this respect, yet it cannot be denied that there were frequent claims and counter claims between the Centre and the States regarding the inclusion of certain items."[34] The terms of reference of the *fifth* Finance Commission provide that the Commission, after finalising its work in July 1969 should make available all the relevant documents to the Union government. "This provision, desirable as it is, puts an end to the inscrutability of the Commission and at once provides a continuing link from which the threads can be picked up for further work by the future Commissions and therefore is a welcome departure from the earlier practices."[35]

In a federal set-up, the Union should be financially viable and solvent and this norm had all along been one of the assumptions upon which the successive Finance Commissions had put up their recommendations. "But, apparently there is a feeling that the commitments of the Centre, particularly in regard to defence and border security and the more recent phenomenon of increasing debt servicing burden, have not adequately been recognized by the Finance Commission."[36] Consequently, the terms of reference of the *fifth* Finance Commission specify explicitly that the Commission should take into consideration the commitments of the Union government.

Another important aspect is the aiming at an objective of regional equalization. The Finance Commissions hitherto have so far concentrated primarily on revenue budgets gaps as a criterion for recommending

[34]*Economic Times*, March 15, 1968, p. 5.
[35]*Ibid.*
[36]*Ibid.*

statutory grants-in-aid. The Plan-grants, on the other hand, have actually been accentuating the regional imbalances through the 'matching criterion' adopted throughout. It is, therefore, essential that the *fifth* Finance Commission should no longer confine to the adoption of 'population' as criterion for regional equalization. The Commission must endeavour positively to aim at balanced regional development and provide for sufficiently adequate non-Plan grants to the relatively underdeveloped States. It is essential that the Commission takes into consideration the long-term developmental needs of the States with reference to their capabilities and potentialities rather than merely attempting to balance temporary gaps in revenue budgets.

Interim Report

The *fifth* Finance Commission submitted an interim report on October 31, 1968. In it the Commission has made final recommendations only on two of the subjects referred to it for reconsideration. One concerns the distribution of grants payable to the States in lieu of the repealed tax on railway passenger fares and the other relates to the mode of distribution of the net proceeds of estate duty on property other than agricultural land. In respect of both these items, the Commission has observed that no change is called for in the existing principles governing the distribution among the States. It has, however, raised the share of the estate duty, attributable to the Union Territories, from two to three per cent. These recommendations will cover a period of five years commencing from April 1, 1969. The Commission has also made recommendations regarding devolution and grants-in-aid for the financial year 1969-70 on the basis of its assessment of the needs of the States for further assistance. The Commission has recommended the continuance of the existing basis of the devolution of the net proceeds of taxes on income (other than corporation tax), net proceeds of Union excise duties, and the net proceeds of additional excise duties on textiles, tobacco and sugar, for the year 1969-70. It has recommended an increase in grants-in-aid to the States from Rs. 140.61 crores in 1968-69 to Rs. 176.81 crores in 1969-70. All these recommendations follow the pattern already laid down, are unanimous and have been accepted.

The Commission has also considered the question of unauthorized overdrafts, drawn by the States on the Reserve Bank of India, in some detail and has made certain recommendations. The issues arising out of such unauthorised overdrafts and the recomemndations of the Commission alongwith other implications are dealt with in the Chapter 11.

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3

Economic Planning and Federalism

The Changing Context

The procedures and practices relating to the Union-State financial relationship have evolved in India in the light of the legacy of the practices introduced by the British before independence, constitutional provisions, and the compulsions arising out of the process of planned economic development since 1951-52. The process of framing the Constitution was completed before the advent of planned economic development in this country and as such though the framers of the Constitution were aware of the need for economic planning, they could not, and did not, anticipate the requirements of a Union-initiated process of planned economic development. Nor did they provide any constitutional provisions and powers for the body which was to be vested with the responsibility of framing, execution and evaluation of the development Plans. All that they provided was a federal Constitution with a built-in bias towards centralisation. As a result, the procedures and practices evolved in the planning process have been more or less super-imposed on the inherited as well as the constitutional procedures and practices. These improvisation and make-shift arrangements have largely been responsible for a certain amount of lack of integration and coordination in this field with the result that they do not effectively serve the purposes for which they are supposed to be the instruments.

Some Guiding Principles

The motivating idea underlying the adoption of the Constitution, of course, was to uphold and strengthen the unity of the country and ensure a balanced and integrated socio-economic development. In a country so large as this and with so much diversities with regards to physical, economic, social and cultural factors, the Constitution had to be, in essence, a federal one in character, so that the constituent units of the federal Union could march ahead within the framework of their own circumstances, serving, at the same time, an integrated socio-economic development of the country.

The spirit of the Constitution provides for, therefore, a certain amount of conditional discretion on the part of the States to frame appropriate policies and measures involving specialized local knowledge and initiative, and in which the overall impact of such policies and measures would be experienced largely within the respective State. The Constitution, therefore, has provided for such a freedom to the States by a clear-cut possible demarcation of the Union, the State, and the concurrent Union-State jurisdiction. The vesting of major and elastic sources of revenues with the Union government has conferred on the Union authorities an effective control in order to ensure a national bias in the overall policies of the State governments.

Notwithstanding the fact that the major sources of revenues were demarcated so as to fall within the jurisdiction of the Union government, the Constitution provided for an equitable distribution of centrally mobilized resources by means of a system of periodical awards by a statutory authority designated as the Finance Commission.

The Constitution did not visualise, however, the changing structure since the advent of planned economic development and the progressively increasing role of the State in this process. Economic planning, as a means towards the attainment of a rapid and balanced growth of the economy with social justice, involves a certain amount of centralization as a matter of necessity, and at the same time, for its due success, certain amount of restrictions on the freedom of individual States to formulate and adopt independent policies, even though allowed under the Constitution. Consequently, several administrative practices and institutions have emerged. *Firstly*, the institution of Planning Commission at the Centre has been made responsible for the formulation of development Plans in terms of the major policy decisions taken by the National Development Council.[1] *Secondly*, throughout this period, the revenue receipts of

[1]The functions of the National Development Council are : (1) to prescribe guidelines for the formulation of the national plan, including the assessment of resources

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the Union have been increasing progressively, and, because of the fact that most of the welfare functions fall within the jurisdiction of the States, their expenditure had correspondingly been rising. This rising expenditure on the part of the States was made possible by aid from the Union, a large part of which was discretionary. A similar trend was seen in the field of receipts and expenditures on capital account, and as a consequence, the major burden of financing public sector Plans of the States has been shared by the Union government in the form of Union grants-in-aid and loans.

These administrative developments have had several adverse effects on the Union-State financial relationship and hence on the healthy development of the process of planned economic development, apart from the fact that they have led to the development of two parallel institutions, viz., the Planning Commission[2] and the Finance Commission—who presently decide about the magnitude of the Union assistance to the States on the basis of different and sometimes conflicting criteria.

for the plan; (2) to consider the national plan as formulated by the Planning Commission; (3) to consider important questions of social and economic policy affecting national development; and (4) to review the working of the plan from time to time and to recommend such measures as are necessary for achieving the aims and targets set out in the national plan, including measures to secure the active participation and cooperation of the people, improve the efficiency of the administrative services, ensure the fullest development of the less advanced regions and sections of the community and, through sacrifice borne equally by all citizens, build up resources for national development.

The National Development Council will make its recommendations to the Central and the State governments and will comprise of the Prime Minister, all Union Cabinet Ministers, Chief Ministers of all States and Union Territories and the Members of the Planning Commission. Delhi Administration will be represented in the Council by the Lt. Governor and the Chief Executive Councillor, and the remaining Union Territories by their respective Administrators. Other Union Ministers and State Ministers may also be invited to participate in the deliberations of the Council. (Government of India, Cabinet Secretariate, Resolution No. 65/15/CF-67 dated October 7, 1967)

[2]The Planning Commission was established by a Resolution of the Government of India dated March 15, 1950. The Resolution referred to the Constitution of India, and especially to certain Directive Principles of State Policy, and stated that in view of these and the "declared objective of the Government to promote a rapid rise in the standard of living of the people", a Planning Commission was being set up with the following functions : (1) to make an assessment of the material, capital and human resources of the country, including technical personnel, and investigate the possibilities of augmenting such of these resources as are found to be deficient in relation to the nation's requirements; (2) to formulate a plan for the most effective and balanced utilisation of the country's resources; (3) on the determination of priorities, to define the stages in which the Plan should be carried out and to propose the allocation of resources for the due completion of each stage; (4) to indicate the factors which are tending to retard

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Thus, the adoption of the process of planned economic development has introduced a new dimension with regard to the Union-State financial relationship—a dimension that was not visualised at the time of framing the Constitution. The process of economic planning in India is guided by three major aims : (a) an accelerated rate of economic growth; (b) a balanced growth of the economically diverse regions with a view to achieve relatively comparable standards of living of the people of all the federating units; and (c) an equalitarian bias. All these aims may not conform necessarily to the same course of action. With the growing financial dominance, the Union government have now got a new lever in the Plans and Plan-assistance in order to introduce a national bias in the State policies.

2

Union Plan-Assistance to the States

Under Article 275(1) of the Constitution, the States receive grants-in-aid from the Union, which are given, as in all federating entities, with a view to levelling off the status of the various units. It may be repeated that the Article in question provides for both general and unconditional grants to 'such States as the Parliament may determine to be in need of assistance', and specific block grants to a State in the form of capital and recurring sums 'as may be necessary to enable that State to meet the cost of such schemes of development as may be undertaken by the State with the approval of the Government of India for the purpose of promoting the welfare of the Scheduled Tribes in that State or raising the level of administration of the Scheduled Areas to that of the administration of the rest of the areas of that State'. The quantum and mode of this assistance are determined by the Finance Commission which is appointed, in terms of the provisions of the Constitution, every five years.

After the advent of the process of planned economic development since 1951-52, however, this form of Union assistance to the States has

economic development, and determine the conditions which, in view of the current social and political situations should be established for the successful execution of the Plan; (5) to determine the nature of the machinery which will be necessary for securing the successful implementation of each stage of the Plan in all its aspects; (6) to appraise from time to time the progress achieved in the execution of each stage of the Plan and to recommend the adjustments of policy and measures that such appraisal may show to be necessary; and (7) to make such interim or ancillary recommendations as appear to it to be appropriate either for facilitating the discharge of the duties assigned to it or on a consideration of the prevailing economic conditions, current policies, measures and development programmes, or on an examination of such specific problems as may be referred to it for advice by Central or State governments.

been overshadowed, slowly and gradually but certainly, by the discretionary assistance from the Union government under Article 282 of the Constitution which is outside the basic provision of the Constitution governing 'Distribution of Revenue between the Union and the States'. Though this provision is only of a permissive nature, to be used as a possible contingency measure, it has come to play a major role, with a substantial step-up in the Union Plan-assistance to the States.

Specific Grants under Article 282

Article 282 of the Constitution empowers the Union government or the State government(s) to make grants for any public purpose even though that purpose may not be within the legislative jurisdiction of the Parliament or the State legislature. Since 1951-52, the Union government has used the powers derived under this Article for making Plan-grants to the States without enacting any law of Parliament and without referring the matter to the Finance Commissions which have hitherto been appointed. The grants made under this Article are specific, assume discretionary nature, and have been made to be applied to Plan-purposes. As such the Union government have been making them as recommended by the Planning Commission. Whereas the specific grants recommended by the Finance Commission, under Article 275(1) of the Constitution, are meant to create compensatory fiscal effects, i.e., in order to provide social and economic services in the various States, the discretionary grants recommended by the Planning Commission, under Article 282 of the Constitution, have been made to enable the States to undertake certain development functions or projects included to be performed by them in the development plans.

For the purpose of grants made by the Union government, under Article 282 as recommended by the Planning Commission, development projects/schemes of the States are divided into two categories : (a) projects/schemes drawn up by the States but assisted by the Union; and (b) projects/schemes sponsored by the Union, States acting as implementing agencies. The former are the projects/schemes which are suggested and initiated by the States, approved by the Planning Commission, and finally included in the development plans of the respective States. The latter are the projects/schemes which are suggested and initiated by the Union government with the consent of the Planning Commission. For the projects/schemes assisted by the Union government, the latter provides 25 per cent of the cost of the project in the form of discretionary grants as specific Plan-assistance; 50 per ent of the cost of the project is provided in the form of loans from the Union government to the State government(s); and the State government(s) concerned are required to meet the balance of 25 per cent of the cost of project from its/their own resources. Thus, such projects/schemes are financed, to the extent of 75 per cent of the cost, by the Union government — 25 per cent in the form of discretionary grants and 50 per cent in the form of loans.

As regards the projects/schemes sponsored by the Union government, the latter may put up the entire cost of the project, entrusting the maintenance of the project after completion to the respective State, or the Union government may decide to meet only a part of the cost of the project, the balance to be put up by the concerned State, depending upon the priority accorded to the project in the development Plan. The Union government, however, attaches certain amount of conditions to the projects/schemes sponsored by them and the concerned State has to accept such conditions if it wants the project/scheme to be located within its jurisdiction. Otherwise the State in question would have to forego both the project/scheme and the assistance from the Union government for its due implementation. Faced with the prospect of losing a project/scheme, no State has ever declined to adhere to the conditions laid down by the Planning Commission, because loss of a project/scheme means deprivation from massive financial assistance from the Union government.

Commenting upon the effective use of this financial string by the Planning Commission/Union government, the Member-Secretary to the *third* Finance Commission remarked: "Under the Constitution, the economic and social planning is a concurrent subject. But many functions undertaken in furtherance of the Plan are entirely in the State field in respect of which the Centre has no constitutional authority to require the States to execute the programme in any particular manner. The only way it can do so is by providing that at least for that part of the programme, which is considered to be of national importance, the States are given a financial inducement in the shape of tied grants to undertake and implement these scheme.......I am not suggesting that the State governments cannot be trusted. But we cannot overlook the fact that in this large and diverse country of ours, there could be difference as to the national as distinct from the State or regional point of view."[3]

In addition to these two forms of Plan-assistance, the Union government, on its own or in cooperation with the State concerned, has been giving specific grants to the non-governmental bodies for the promotion of activities like social welfare, village industries, development works of a local character, subsidised housing schemes, training of personnel for community development projects, public health, scientific research, University education, public administration, etc. The data regarding all these types of grants made by the Union government under

[3]Kamat, G.R., *Report of the Third Finance Commission*. New Delhi, 1961, p. 56.

Article 282 of the Constitution are not readily available. However, total amounts of grants made by the Union government to the States under this Article, alongwith the statutory grants made on the recommendations of the successive Finance Commissions and the Union loans to the States, since 1951-52 are given in the table below :

Union Grants-in-Aid and Loans to the States since 1951-52

(Rs. Crores)

	First Five Year Plan 1951-52 to 1955-56	*Second Five Year Plan 1956-57 to 1960-61*	*Third Five Year Plan 1961-62 to 1965-66*	*1966-67 (Actuals)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)
A. Statutory grants	104	207	329	153	150	151
B. Discretionary grants	168	520	983	290	354	353
C. Loans*	799	1411	3142	935	902	856
Total	*1071*	*2138*	*4454*	*1378*	*1406*	*1360*

*Gross of repayment of loans by the States to the Union.

Source : Government of India, *Explanatory Memorandum on the Budget of the Central Government* for 1967-68, pp. 107-110; and *Reserve Bank of India Bulletin,* April 1968, pp. 418-456.

It may be observed that the quantum of grants-in-aid from the Union to the States has shown a progressive increase with the successive Five Year Plans. Statutory grants increased from Rs. 104 crores in the First Five Year Plan to Rs. 207 crores and Rs. 329 crores in the Second and Third Five Year Plans respectively. As against an annual average of Rs. 66 crores during the Third Plan period, the average works out to be at Rs. 151 crores for the years 1966-67, 1967-68 and 1968-69. A similar trend has been shown by the discretionary grants. From Rs. 168 crores during the First Plan period, the amount of these grants increased to Rs. 520 crores and Rs. 983 crores during the Second and Third Plan periods respectively. Compared to an annual average of Rs. 197 crores for the Third Plan period, the average for the years 1966-67, 1967-68 and 1968-69 works out to be at Rs. 332 crores.

Another feature of the trend is that in the totality of grants, i.e., statutory grants plus discretionary grants, notwithstanding the fact that both have shown rising trends, the relative importance of statutory grants has declined and correspondingly that of discretionary grants has increased. During the First Plan period statutory grants constituted 38.2 per cent of the total grants. The ratio reduced to 28.5 per cent during the Second Plan period and further to 25.1 per cent during the Third Plan period. The Plan expenditure during the years 1966-67, 1967-68 and 1968-69, both on account of the Union government and the State governments, were targeted to be of the order of Rs. 2,082 crores, Rs. 2,246 crores and Rs. 2,337 crores respectively. The relative stagnancy in the public sector annual plans and the consequential reductions in the Union grants to the States explain the percentages of 34.5, 29.6 and 29.8 for the years 1966-67, 1967-68 and 1968-69 respectively.

Taking into account the impact of discretionary grants plus the Union government's loans to the States, it implies that these two sources of financial discretion vested in the Union government can effectively be used in order to achieve the overall objectives of economic planning in a federal set-up. This in turn would depend upon the norms and basis on which this discretion is applied in practice and the efficiency with which the funds received are utilized by the recipient States. Past experience, however, is not very reassuring. "The concept and formulation of the detailed schemes of assistance suffered from many defects. The general principle underlying them was that the Central Departments, which more than the Planning Commission, framed the schemes, know not only more about national priorities of development which could be accepted as they had the advantage of operating on the national scale, but also about the detailed methods of achieving them. This exaggerated claim has not been supported by events. In knowledge of local needs, resources and limitations, the State governments were definitely superior; and there were instances where by its insistence on certain schemes not suited to local conditions, the schemes became liable to abuse. To the extent to which they were strictly adhered to, the patterns only succeeded in stifling local initiative and enterprise."[4] Moreover, "the schemes do not seem to have ever received a scientific comprehensive view. Since there was no detailed pre-budget scrutiny and supervision was out of question, there was no guarantee about the end results. Financial supervision continued, but physical results were not linked up with it, and the final result could not be vouchsafed."[5]

In this connection, certain other developments also deserve mention. *Firstly,* since no definite criteria have been laid down by the Planning Commission with regard to the Union assistance to the States, all sorts of devices and subterfuges are devised by the States with a view to obtaining as large a quantum of Central assistance as possible. "There has always been a tendency to emphasise the 'needs' aspect of the Plan rather than its 'resources' aspect. The result is that size has tended to be out of

[4]Lakdawala, D.T., *Union-State Financial Relations.* Bombay : Lalvani Publishing House, 1967, pp. 100-101.

[5]*Ibid.,* pp. 101-102.

proportion to resources. This in turn has fostered an element of unreality in the formulation and implementation of the plans at the State level. Governments are tempted to exaggerate their requirements and ask for increasing aid from the Centre."[6] *Secondly*, the absence of an efficient planning machinery at the State level reinforces this tendency. "A State Plan is framed by a State keeping in view the national priorities announced by the Planning Commission, the likely size of all-India Plan and its own needs and resources. There is a general complaint that the latter two do not get their proper consideration, for the State has seldom an expert body of its own to plan on a long-term basis in the light of national requirements and its relative resources, material and financial. In its absence no real planning at the State level is possible. The State, especially if it is a backward one, feels greatly overawed and overwhelmed by the expertise and knowledge of the Central Departments and the Planning Commission. Though the State Departments prepare their own plans, in their turn they largely rely upon the opinions and expertise of their counterparts in the Central government, and coordination at the horizontal level is relatively weak."[7] *Thirdly*, quite often, the two objectives of the Constitution—conditional freedom to the States to evolve policies suited to their local milieu and introduction of a national bias in the State policies—are not attained. The States have adhered to the pattern of expenditure as proposed by the Planning Commission even when it was not suited to their needs or when the assistance was not linked to a specified pattern, utilized it sometimes in a manner different from that proposed by the Commission.

Notwithstanding these comments, it must be recognised that it is the Planning Commission who are responsible for formulating the development Plans, determining the objectives and priorities, and also, to a considerable extent, for allocating the scarce investible resources with a view to achieve the overall targets of development programmes. Accordingly, it is the Planning Commission, which is, by its very constitution and functions, the most competent agency to advise on the distribution of Plan grants and loans. But there must be a rational and objective approach to the problem of allocating Union assistance to the States against the background of the overall objective of a balanced but accelerated rate of growth with social justice.

The foregoing review of the Union assistance to the States shows that, in respect of Union grants-in-aid to the States, the functions of the Finance Commission on the one hand and that of the Planning Commission on the other, have tended to overlap quite considerably. Naturally,

[6]Administrative Reforms Commission, *Report of the Study Team on Financial Administration*. New Delhi, May 1967, p. 78.

[7]Lakdawala, D.T., *op.cit.*, pp. 79-81.

it has created a not inconsiderable amount of confusion in the criteria adopted in the determination of Union grants-in-aid to the States. Apart from this, there is also a problem of the procedures, forms and modes of the Union assistance, especially in regard to the assistance determined by the Planning Commission. Unlike the statutory assistance given under the awards of the Finance Commission, the Plan assistance is generally for specific purposes. Originally, the form and procedures devised in this connection were such as to enable the Planning Commission and the concerned administrative Ministries of the Union government to keep a proper watch over the end-use of the assistance by the States. This naturally resulted in a multiplicity of patterns. Subsequently, these patterns were revised and modified to permit greater scope for flexibility in the use of assistance.

3

The Planning Commission and the Finance Commission

As already mentioned earlier, Article 280 of the Constitution provides for an independent quasi-judicial expert body, known as the Finance Commission, for recommending the principles and proportions of financial transfers from the Union to the States through the 'built-in' balancing devices. The role of the Finance Commission is governed by the basic principles of federal finance, which seeks to meet the residuary budgetary needs of the States, after taking into account the devolution of the proceeds of the Union taxes to the States. The underlying idea is that the constituent units, being at different stages of development, need to be brought upto a minimum level, thereby aiming at 'equal sacrifice and equal opportunity'. In the light of this basic principle, the various Finance Commissions devised their own schemes for determining the quantum of statutory assistance to the States. By and large, the emphasis has been on the need to meet the budgetary gaps of the States.

The process of planned economic development has changed, however, the entire fiscal context in the economy since 1951-52. The criterion of 'budgetary needs', implicit in the Finance Commission's recommendations, was put into insignificance by the impact of Plan expenditure, growing as it did in all these years of economic planning. The formulation of Plans at the State's level, their incorporation in the national Plans and their implementation at the State's level, formed a big charge on the Union exchequer, in fact, if not in theory. The tax sources of the States having been relatively narrow and inelastic, their financial resources for putting through the Plan schemes had to be supplemented by increasing assistance from the Union. Consequently, the criterion of the 'budgetary needs'—a concept which considers the gap in current revenues and expenditures for allocation of Union assistance—gave way to the concept of 'fiscal needs'. The latter concept is of much wider economic significance which interprets the gap in resources in an overall context of total expenditure of the State.

This gradual, but perceptible, change in the Union-States' financial relationship influenced, to a considerable extent, the thinking of the successive Finance Commissions. The *first* Finance Commission recognized the need to take into account not only the 'budgetary needs' but also the 'fiscal needs' arising out of the execution of development programmes. The same view was reiterated by the *second* Finance Commission which recommended Central assistance to the States so as to enable them to put through the Plans. It was left to the *third* Finance Commission, however, to incorporate this view, in quantitative terms, in its recommendations. The *fourth* Finance Commission, guided by its terms of reference to take only non-Plan expenditure into account, calculated the non-Plan revenue gap on the basis of its scrutiny of the estimates submitted by State governments and recommended its complete elimination through Union assistance.

The limitation of the scope of the recommendations of the Finance Commission to take into consideration the non-Plan requirements of the States while putting up its recommendations, and as a consequence leaving the mode, quantum and criteria for allocation of resources for Plan expenditures to be determined by the Planning Commission, has not been effected by any amendment of the Constitution, but only by altering the terms of reference of the Finance Commission. Otherwise, excepting the limitations arising out of the terms of reference, there is nothing to preclude the Finance Commission to take into consideration requirements arising out of Plan expenditures too. "Nowhere in these Articles is there an express or implied indication that the total revenues of a State should be utilized only for revenue expenditure......It is abundantly clear to my mind that the reference in the main part of clause (1) of Article 275 to grants-in-aid to the revenues of States is not confined to revenue expenditure only......There is no legal warrant for excluding from the scope of the Finance Commission all capital grants; even the capital requirements of a State may be properly met by grants-in-aid under Article 275 (1), made on the recommendations of the Finance Commission......The legal position, therefore, is that there is nothing in the Constitution to prevent the Finance Commission to take into consideration both capital and revenue requirements of the States in formulating a scheme of devolution and in recommending grants under Article 275 of the Constitution."[8]

The role of the Planning Commission with regard to the allocation of Union assistance to the States is, without doubt, much wider and in terms of magnitude more effective and decisive. Precisely speaking, its role is confined to the needs arising out of additional current outlays and the total expenditure on capital account which is projected while formulating the Five Year Plans. The Planning Commission helps in the formulation of the State Plans, ship-shapes them, in an overall perspective of the nationwide strategy of economic growth. For that purpose, it considers the budgets of the State governments in their entirety including the non-Plan revenue and capital expenditure, and then the quantum of the Union assistance to the States is determined. To that extent, two considerations are borne in mind : (1) the gap in the State Plans, after allowing for additional taxation and borrowing; and (2) the commitment involved in fulfilment of the centrally sponsored schemes, embodying therein the matching principle.

These developments in the flow of Union assistance since the advent of an era of planned economic development point out that the two bodies, the Finance Commission and the Planning Commission, have overlapped considerably while determining the quantum and flow of such Central assistance. More often than not, these functions, as discharged by these two bodies, have resulted in contradictions, disturbing thereby the harmony in the Union-States' financial relationship. More particularly, it has led to the following developments:[9]

Firstly, the estimates submitted by the State governments to these two bodies are not consistent. As the Finance Commission is engaged in filling the 'revenue gap', there is a temptation for the States to present figures which underestimate their resources. On the other hand, under pressure to increase their Plan size and show the necessary resources for them in their submissions to the Planning Commission, they consistently overestimate their resource-raising potentialities and capabilities at current rates of taxation and prices and underestimate their non-Plan expenditure liabilities, as the more they undertake to raise, the more they are likely to get. Considering that the process of Plan formulation has not generally coincided with the deliberations of the various Finance Commissions (except in respect of the *fourth* Commission) it is not very difficult for the State governments to give two sets of figures to these bodies.

[8]Minute by P.V. Rajamannar, Chairman, ***Report of the Fourth Finance Commission***, New Delhi, 1965, pp. 88-89.

[9]Administrative Reforms Commission, "Report of the Working Group on State Finances and Centre-State Financial Relations", in the ***Report of the Study Team on Financial Administration***. New Delhi, May 1967, pp. 363-365.

Secondly, the functioning in isolation of these two Commissions leads some relatively more developed States to fudge the figures. Since the statutory assistance under the Finance Commission's awards is given to those States which have a gap in their non-Plan revenue account, these States are either listless and indifferent to the Finance Commission or if at all they show any interest, they manoeuvre a gap in the revenue account. The approach is reversed when they place the case before the Planning Commission.

Thirdly, following from the above, the distinction between Plan expenditure and non-Plan expenditure, drawn by the two Commissions for the purpose of allocation of Central assistance, leads to a considerable amount of manoeuvre on the part of the States and the resultant confusion.

Fourthly, when the Plan expenditure is continuing and is progressively increasing, the non-Plan expenditure, in so far as it is functionally related to the Plan expenditure, also increases likewise. It is added, therefore, that the datum which one body considers as relevant is totally ignored by the other. Since it is the total expenditure which is pertinent, it should be the total assistance that must be the concern of any body charged with the allocation of Central assistance.

Finally, the major objective of statutory assistance is to bring up the backward States to a minimum level in relation to the relatively more developed States. This incidently is also one of the important objectives of the Union assistance determined by the Planning Commission. In order to aim at balanced regional development, the Planning Commission allows for the relative backwardness of a State or region while formulating the strategy, structure and substance of a development Plan. The Finance Commission ignores, however, the Plan expenditure of the State which is designed to aim at, among others, levelling the regional economic disparities.

It will be observed, therefore, that the dichotomy in the functions of the two bodies, the Finance Commission and the Planning Commission, in determining simultaneously the quantum of Union assistance to the States has not resulted either in devising consistant and rational criteria for Union assistance or bringing about its allocation among States consistent with the Plan objectives. "One of the main objectives of Central assistance to States has been to ensure that the States implement effectively those schemes and projects which have a certain rationale in the overall context of the national economy. In other words, the pattern of assistance devised was designed to facilitate the use of Central funds in channels predetermined in the Plan. When it was found that these objectives were not achieved on account of lacunae in the procedures underlying the release of Central assistance, many reforms were introduced to simplify the procedures. Even then the main objective of ensuring that the funds were used so as to achieve certain rusults has remained largely unfulfilled. Instead what has been achieved is an artificial uniformity in the schemes and projects of different States."[10] What is necessary, therefore, is clearly defined objectives and procedures of Central assistance.

4

Some Suggestions

The Planning Commission, it may be repeated, is charged with the responsibility of making an assessment of the material, capital and human resources; framing development Plans for the most effective and balanced growth of the economy; determining of priorities; and determining the nature of machinery to secure due implementation of the Plans with a view to raise the rate of overall economic development of the country and to persue the objective of achieving balanced regional development. To this end, drawing upon the provisions under Article 282 of the Constitution, the Planning Commission has been determining the allocation of investible resources of the government whose quantum has been increasing with the successive Five Year Plans. Therefore, "in a planned economy, its needs and resources will have to be viewed in toto. The allocation of resources will have to be consistent with the objectives and priorities laid down in the Plans. The process of organization and utilisation of resources is a joint responsibility of the Centre and the States. The old federal principle, which regards all the constituent units as independent of each other in their own spheres, has to give place to what may be called the idea of cooperative federalism. All the arrangements for Centre-State transfers of resources will have to be based on the consideration of rapid economic growth without prejudice to the idea of 'federal justice'."[11]

In the context of overall economic development, therefore, the dominant role the Planning Commission is playing as at present should be retained. But, the functions and respective spheres of operation of the two bodies, viz., the Planning Commission and the Finance Commission, in so far as they concern determination of the transfer of resources from the Union to the States, should be statutorily defined. This will

[10]Administrative Reforms Commission, *Report of the Study Team on Financial Administration*. New Delhi, May 1967, p. 79.

[11]Oommen, M.A., "Re-examination of Union-State Financial Relations Overdue", in *Yojana*, October 13, 1968, p. 3.

help to clear the lingering doubts and to avoid possible clash of interests between the Union and the States on the one hand, and the Planning Commission and the Finance Commission on the other. To that extent the following suggestions are put forward.

(1) The present existence of the Planning Commission should be accorded a constitutional status so as to give it a position of something more than an advisory body. "A mere advisory committee of experts can wield but feeble weapons against Central ministries and State governments which are chafing at the restrictions imposed upon them by a Plan, and all trying to go their own ways, often in the genuine conviction that their sectional interests coincide with the national interests. Unless there is a strong countervailing force, these centrifugal pulls can disintegrate a plan very quickly......What the Indian system, with all its faults, avoids is the situation, so dismal to the serious planner, in which the experts sit insolated and neglected in small back rooms, drawing up projections of economic development and making policy recommendations which few of the politicians read and none feel committed to it."[12] Professor A.H. Hansen adds, therefore, that "the cardinal virtue of the Indian system is that it has put political teeth into planning."[13] A constitutionally constituted Planning Commission should, however, be a body consisting of technical experts and proved administrators with their counterparts at States' level. It should strictly be a non-political body with a well defined executive powers.

(2) The respective spheres of jurisdiction of the Finance Commission and the Planning Commission should very definitely be demarcated by *either* suitable amendments in the Constitution *or* by conventions. In this connection, it may be suggested that since the Planning Commission is responsible for formulating development Plans for the entire economy, and since, with a view to ensure the coordination of the Plan priorities and programmes of different States, it is expected to have an integrated and balanced view of the whole of the economy, it should be entrusted with the responsibility of recommending grants under the Article 282. Only the distribution of general grants under Article 275 should be made the responsibility of the Finance Commission, confined only to recommend on the mode of distribution of the proceeds of divisible taxes and levies, and to recommend grants-in-aid to fill up the non-Plan gaps in the revenue budgets of the States. Further, as regards the Union loans to the States for due implementation of Plans, the Planning Commission should have the power to determine the quantum of such loans and the

[12]Hansen, A.H., *The Process of Planning*. London : Oxford University Press, 1966, p. 72.

[13]*Ibid.*, p. 73.

norms on which they should be granted. It is felt that this rational division of responsibility should have been done long ago in order to avoid the duplicity of functions of the two bodies and the resultant administrative confusion and misunderstanding between the Union authorities and the States.

(3) Recommendations of the Planning Commission in respect of Union Plan-grants and the Union loans to the States should be accorded a statutory sanction by suitably amending the Article 282 of the Constitution. In this connection, two further issues may be spelt out. *Firstly*, there must be some objective and definite criteria for the determination of the Union assistance to the States both for Plan-grants as well as loans as recommended by the Planning Commission. The National Development Council, quite recently, laid down that the following criteria should govern the distribution of Union assistance to the States during the fourth Five Year Plan : (a) population, (b) per capita income, (c) per capita taxation in relation to per capita income, (d) spill-over on account of continuing major irrigation and power schemes, and (e) special problems of the States. As regards weightage that should be accorded to each of these criteria, the Planning Commission was asked to work out a set of different models of distribution of Union assistance among the States. It is encouraging that the National Development Council and the Planning Commission are already seized of the problem. *Secondly*, the recommendations of the Planning Commission must follow close examinations of the recommendations of the Finance Commission regarding the distribution of tax proceeds and the grants under Article 275 of the Constitution. This procedure will assure proper coordination of the recommendations of the two bodies and will enable the Planning Commission to have a composite look upon an integrated scheme of allocating scarce national resources as between the Union and the States on the one hand and the States *inter se* on the other. In this connection it is imperative that : (a) the period covered by the recommendations of the Finance Commission should invariably correspond to that of the Five Year Plans; (b) the assessment of the needs of the States, both on revenue and capital acounts, should be made by the Finance Commission and the Planning Commission in coordination with each other—two separate assessments based on two sets of projections submitted to the two bodies separately, as they are made currently, should be avoided; and (c) in order to have an effective coordination between the two bodies, it may be worthwhile to appoint one member of the Finance Commission from amongst those of the Planning Commission.

(4) As it is recommended that the Planning Commission should also be a statutory body with extended functions, the present provisions regarding periodical appointment of the Finance Commission should be

retained. The scope and the functions of the Finance Commission in the aforesaid demarcation would remain more or less the same as they are as at present. It would be sufficient that the Finance Commission is appointed everys five years to enquire into the problems of inter-State inequalities of income and of social and economic services, and recommend adequate equalising financial transfers.

(5) The Plan-assistance from the Union to the States should not be tied to specific schemes/projects in the State Plans. The States should be free to spend it in any way they consider proper in the advancement of Plan objectives. This freedom will enable the States to introduce flexibility in their development programmes in the light of the developing situations. At the same time, the periodical review of the progress of development programmes of the States by the Planning Commission can be used to ensure proper furtherances of national objectives.

The aforesaid suggestions are offered to eliminate the overlapping of functions of the two bodies. The position and functions of the Planning Commission vis-a-vis the Finance Commission, require to be enhanced by giving them constitutional recognition, while both the bodies would be retained with clear-cut demarcations of functions performed in a coordinated manner. Federalism is a political mean to subserve certain economic, political and social objectives. In this country, our socio-economic goals are an accelerated rate of economic development with objective to establish a socialist society through the instrumentality of democratic planning. The measure of success which can come about would depend partly upon constitutional and other devices for healthy and constructive development of economic and financial framework, and partly to the extent we take advantage of opportunities coming in the process. A well established, sound but flexible institutional framework for Union-State financial relationship is one of the most important pre-requisite towards this end.

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4

. General Principles of Financial Administration

The Scope of Financial Administration

Financial administration is one of the most important facets of public administration and as such it is concerned with all the aspects of financial management of the State. Financial administration as a subject concerns itself also with public finance and deals with the principles and practices relating to the proper and efficient administration of the finances of the State. On its practical side, financial administration is "that part of government organisation which deals with the collection, preservation and distribution of public funds, with the coordination of public revenues and expenditure, with the management of credit operations on behalf of the State and with general control of the financial affairs of the public household."[1] It will be observed that the former definitions of financial administration deal with the theoretical aspect of the problem whereas the latter emphasises the practical implications.

Quite recently the importance of financial administration has developed for a number of reasons. Among them the more important are discussed in the following paragraphs.

[1]Jeze, Gaston, "Financial Administration", in Fagan and Macy, *Public Finance*, p. 847, quoted in Pinto, P. J. J., *System of Financial Administration in India*. Bombay : New Book Company, 1943, p. 13.

Firstly, the conception of a welfare State has resulted in the ever increasing activities of the State. This development has resulted in a phenominal growth of public expenditure and as a consequence of revenue quite necessarily. This has naturally led to a complicated system of management of State finances. This branch of public administration must, therefore, be handled by the experts competent to make through the mass of details, complexities and intricacies connected with the efficient administration of the State finances.

Secondly, in a democratic set-up as that of India where the elected representatives of the people are to run the affairs of the State, financial administration must be adapted to conform to the requirements of democratic institutions. In order to serve the needs of such democratic institutions, therefore, the procedure of financial administration must be a simplified and systematised one, so as to be easily comprehensible and understandable by the ordinarily intelligent citizens, at least so far as the outlines of the subject are concerned. How to set up a financial system so as to ensure efficiency and expediency on the one hand and public control exercised by different democratic institutions on the other; how to coordinate the work so as to make the system ordinarily intelligible without sacrificing the essential technicalities; and how to make the most efficient and fullest use of the revenues of the State, has become, of late, one of the most difficult problems of public administration.

Thirdly, the influence of tremendous advancement in the management techniques has naturally extended itself to the field of financial administration. "Science makes for order and simplicity and so in finance there has been the search for a more simplified and rationalized procedure. One even gets the suspicion that people, machine minded as they are fast becoming, want something that works automatically. No social science, however, can achieve the exactitude of the mechanical sciences; yet we can always work for an administration that is more simple, understandable and efficient."[2] The more the people understand the complex working of the State machinery, the greater interest will they arouse in the State administration; and more beneficial it will be for the development of the democratic institutions.

2

Problems of Financial Administration

The scope of financial administration, therefore, encompasses the system of financial administration and the norms on which such a system

[2]Pinto, P .J. J., *op.cit.*, p. 14,

should be based. In order to evaluate the effectiveness and efficiency of a system, we must spell out the aims which such a system attempts to satisfy and the problems involved towards that. Gaston Jaze's definition, quoted above, points out to four processes of financial administration, viz., (a) collection of public revenues, the custody of public moneys thus collected, and affecting payments; (b) a proper coordination of public revenues and expenditures through a well-drafted and well-considered plan; (c) public borrowings and management of public debt; and (d) the general management and control of financial affairs of State or governmental unit(s), particularly the management and control of the financial affairs of the public enterprises. The *first* concerns itself with the handling of public moneys; the *second* with the budget proper, i.e., preparation of the budget and its adoption by the legislature; the *third* with the debt operations; and the *last* with general financial control.

An approach to the problems of financial administration may also be viewed from : (a) raising revenues, (b) incurring expenditures, and (c) the custody of public moneys.

In a parliamentary democracy, the sources of revenues and the conditions under which such revenues can be raised, are determined, in accordance with the provisions of the Constitution, and sanction by the legislature. The executive government is responsible for organising and operating a proper machinery for the raising of revenues and the raising of public loans. Control is exercised through a comprehensive and well coordinated accounting system, and through a statutory audit undertaken by an authority who is independent of the executive government. The results of all these stages are summarized in reports to the appropriate authorities, i.e., the legislature.

3

Principles of Financial Administration

Viewed from the practical side, financial administration is supposed to deal with the specific problems arising therefrom. On the theoretical side, however, it concerns itself with the "principles which should guide the general administration of the government and other governmental organisations for specific purposes".

Firstly, a sound system of financial administration means unity of organisation. "The more unified the different agencies of the government are and the more centralised the responsibility of the hierarchy of officials, the more efficient is the administration. This centralisation does not mean that everything is done by a few at the top; details must be left to the discretion of the subordinate officers. But it does mean that the work of the different agencies is coordinated and rightly evaluated in any financial scheme of the government."[3]

Secondly, in a structure of parliamentary democracy, the system of financial administration must be organised and operated in a manner as to secure compliance with the will of the legislature as expressed through the Appropriation Act and the Finance Act. The executive government must raise the revenues, borrow moneys and incur expenditures on purposes specifically expressed by the legislature. In order to exercise a control on these financial functions of the executive government, the legislature takes an account of such activities through a statutory audit organisation which is independent of the executive government.

Thirdly, a sound and efficient system of financial administration presupposes simplicity, promptness and regularity in functioning. "Simplicity is required to economise and make the system understandable to the people. Promptness has not always been a virtue of governmental financial administration. It is obvious, however, that a government cannot afford to give its decisions without due thought and regard for its policy in the past or the repercussions to its decisions in the future. Regularity of functioning is essential to efficiency......A government department cannot afford to function at intervals, for administrative work is continous."[4]

Fourthly, there should be an efficient and effective, but not too much complicated, control over all the stages of financial administration. Such a control is exercised by the executive government normally through the Finance Ministry/Department or Treasury and by the legislature through the audit organisation which is independent of the executive government. Further, such a control must be backed up by people who command great amount of honesty, legality, integrity and capability. "The stability of the country, the continuity of policy, efficient execution of sanctioned plans, and careful handling of finance are in great measure due to the men of Services who by their ability and experience are in an excellent position to put large schemes into execution; and not only to the upper ranks of the Services but also the subordinate to whom discretion in matters of detail must necessarily be given......Even if the system of administration is not upto the standard, first rate personnel can easily make up for the defects; on the other hand, not even the best devised system with all its checks and controls can be effective if the personnel of the administration is inefficient or corrupt, for 'the public spirit of the servants of the State is the spirit that gives life to dead rules and regulations'."[5]

[3] *Ibid.*, p. 17.
[4] *Ibid.*, p. 19.
[5] *Ibid.*, p. 20.

4

The Budget as an Instrument of Financial Administration

The fourfold aims of financial administration, described in the preceding paragraphs, are sought to be realised through the budgetary system, i.e., the system through which all the financial affairs of the State are regulated. It is through the budget that the executive government forecasts and plans up its revenues and expenditure for the ensuing year. It is through the budget that the executive government exercises an effective control over the administrative organisations and then by the legislature over the executive government. "The Budget does not directly control certain functions of the administration, e.g., public debt management, collection, custody and disbursement of moneys, etc. Yet every function of a financial nature must find itself expressed in one way or another in the budget. Borrowing must be authorized by the legislature, and before loan moneys can be spent they must be budgeted for; collection of revenues is exhibited on the revenue side of the budget, disbursements on the expenditure side, while moneys in custody are shown in the debt, deposits and remittance section."[6]

The adoption of the system of budget by almost every country in the world as an instrument of financial administration has been considered to be vital for an efficient and economical administration of the public affairs.

The Definition of the Budget

"Budget is a term derived from the old English word bougett, the sack or pouch from which the chancellor of the exchequer extracted his papers in presenting to Parliament the Government's financial programme for the ensuing fiscal year."[7] By the term 'budget' it is commonly understood that it is a document presented by a government containing an estimate of proposed expenditure for a given period and proposed means of financing them for the approval of the legislature. Still the term budget has been defined by different authorities in various ways. According to Rene Stourm, a distinguished French authority on budgeting, "the budget of the State is a document containing a preliminary

[6] *Ibid.*, p. 21.

[7] *Encyclopaedia of the Social Sciences*. London : Macmillan Company, 1950, Volume Three, pp. 38-39.

approved plan of public revenue and expenditure."[8] Another French authority, Paul Leroy Beaulieu defines budget as: "the budget is in the first place a statement forecasting revenues and expenditures during a certain determined period of time. It is also an authorization or an order by competent authorities to make the expenditures and collect the revenues."[9] A.E. Buck speaks of three essential elements in a budget: (1) a financial plan, (2) a procedure for formulating, authorising, executing and controlling the Plan, and (3) some governmental authority responsible for each successive stage in this procedure.[10]

The French Public Accounting Law defines the budget as follows: "The budget is a document which forecasts and authorises the annual receipts and expenditures of the State and of the other branches of service which by virtue of the law are subject to the same rules and regulations."[11] "The real significance of the budget system is to provide for the orderly administration of the financial affairs of a government. The conduct of such affairs involves a continuous chain of operations, the several links of which are: estimates of revenue and expenditure needs, revenue and appropriation acts, accounts, audit and reports. An estimate is first made of the expenditures that will be required for the proper conduct of governmental affairs during a fixed period usually one year, together with proposals for raising the money to meet these expenditures. On the basis of this estimate revenue and appropriation acts are passed giving legal authority for the action determined upon. Following this the operating services open revenue and appropriation accounts corresponding to the items of revenue and appropriation acts and proceed to expend money so voted. The data recorded in these accounts are examined by the auditing and accounting departments to ensure their accuracy, to see that they correspond to the real facts and represent a full compliance with all provisions of law. The information furnished by these accounts is then summarised and given publicity in the form of reports. Finally on the basis of these data new estimates for the next year are made and the circuit is begun again. In this chain of operations the budget is the instrument, through which the several operations are correlated, compared and examined at one and the same time."[12]

The budget is thus more than a mere estimate of revenues and

[8]Rene Stourm, *The Budget,* translated from the seventh edition by Thaddeus Plozinski. New York: D. Appleton and Co., 1917, p. 4.

[9]*Ibid.,* p. 37.

[10]Buck, A.E., *The Budget in Governments of Today.* New York: Macmillan, 1934, p. 46.

[11]Rene Stourm, *op.cit.,* pp. 2-3.

[12]*Encyclopaedia of the Social Sciences, op.cit.,* p. 39.

expenditures. It is, or should be, a report, an estimate and a proposal. *More precisely, it is a document through which the chief executive, as the authority responsible for the actual conduct of governmental affairs, presents to the fund-raising and fund-granting authority a full report* regarding the manner in which he and his subordinates have administered affairs during the last completed year, and a statement of the present condition of the public treasury. On the basis of such information the executive sets for the programme of work for the coming year, with proposals as to the financing of such work.

It may be seen that there are so many definitions of budget but the difference among them is very minor. From a practical point of view the term 'budget', as it is generally understood, refers to the statement or document(s) placed by the government before the legislature every year on or after a specified date, setting forth the anticipated expenditure of the government during the next financial year (called the budget year) and the receipts for the same period : (a) under the existing laws in force, and (b) as a result of the taxation proposals, if any contemplated by the government. The primary objective of the budget is to reveal comprehensive information in order to present a complete picture of the financial position of the government and thereby enabling the legislature to measure adequately the impact of such financial programme on the country's economy. The estimates, however, must be as accurate as possible, for any wide divergence of the actual receipts and disbursements from the estimates may seriously dislocate government financial arrangements.

More particularly, by the term 'budget' we mean a set of documents containing : (a) a review of the expenditures incurred, revenues collected, and other matters relating to the financial year immediately preceding the year for which the budget is prepared and presented to the legislature; (b) an estimate of expenditures during the forthcoming financial year and the extent to which such expenditures are expected to be covered at the rates of taxation prevailing for the time being; and (c) proposals for changes, remission or imposition of fresh taxes as may be required to balance the expenditure.

Main Characteristics of a Budget

A short, but comprehensive, definition of the term 'budget' must, however, be based upon the main characteristics which a budget normally possesses. These characteristics are :

(1) The budget is a plan or programme, framed on the basis of past experience, and such a plan or programme must be systematic and organized and must be ready for execution. Such a plan or programme

derives its inspiration from the economic, political and social policy of the government and the economic ideology accepted by the country in question. *This plan or programme is prepared in financial terms.*

(2) The budget is not merely a preliminary proposal, it is rather a scheme for action. The proposal has no meaning unless it is accepted. The budgetary procedure in almost all the countries is such that the budgetary proposals originating from the executive government are accepted by the legislature, sometime with minor modifications here and there.

(3) The estimates included in the budget are simply estimates; the actuals, when the budget is executed, may not conform with the original estimates. The budget must, however, estimate revenues and expenditures as accurately as possible. Accuracy becomes essential if equilibrium established in the estimates is to be maintained to the end and realized in actuals. Besides, an estimate, unless it is fairly correct, ceases to be an estimate and degenerates into a mere guess.

(4) It is a comprehensive plan of action. "By comprehensiveness is meant that the budget brings together in one consolidated statement all the financial requirements of the government, whether of income or expenditure, and all the facts of the financial conditions of the government whether these requiremets and facts relate to the experience of the past or the problems of the present or the estimates of the future."[13] "The most important feature of a budget is comprehensiveness. It must assemble in one consolidated statement all facts regarding expenditures and revenues, past and prospective, the actual financial condition of the treasury and the condition of the treasury as it will be if the proposals contained in the budget are put into execution. These facts, moreover, must be presented by means of balanced statements, so that the relations between past action and proposals for the future, between revenues and expenditures and between resources and obligations may be clearly seen. Thus the budget presents the whole problem of financing the government at one time and focusses legislative attention on the relation of the total expenditure needs to the total prospective revenues."[14] In other words, the budget must show all the revenues and all the expenditures of the government, and this not in several unrelated totals, but in a unified statement.

(5) It is generally an annual plan, although occasionally it may sometime cover a longer period. The year is a customary period based on natural phenomena of great significance for the economy of a country. Perhaps, the most cogent reason for taking a year as the budget period is

[13]Pinto, P. J.J., *op.cit.*, p. 27.
[14]*Encyclopaedia of the Social Sciences*, *op.cit.*, p. 39.

that "it is not too long for accurate estimating; and it is probably the shortest period that will not consume too much of the legislative session in the consideration of the budget."[15]

(6) Invariably, the budget is prepared and presented on behalf of the executive. No private member can present a budget in the legislature.

(7) In a parliamentary democracy, the budget is put before the legislature for legislative sanction.

Taking into account all these characteristics of the budget, the term 'budget' may be defined as "a comprehensive plan or programme, ready for execution, containing estimates of expenditure and revenues, for a definite period, usually a year, prepared and presented by the executive to the legislature for a vote."

5

Basic Objectives of a Budget

Some of the more important objectives of the budgets of the modern governments are: (1) to ensure accountability; (2) to serve as a tool for management; (3) facilitating a functional approach; (4) performance or accomplishment; (5) coordination and correlation with the Plan; (6) to facilitate economic analysis; and (7) an instrument of fiscal policy.

Accountability : Accountability has been and should continue to be the outstanding feature of the budget, more particularly in a parliamentary democracy. One of the well-established principles of a system of parliamentary democracy is that the legislature exercises a control over spending of public moneys and that no taxes or levies are imposed without its express sanction. A system of annual budgets is designed to secure such a control of the legislature over the finances of the State. It follows that a budgetary system should be such as to ensure that the amounts voted by the legislature under various heads of expenditure are not exceeded and that they are not spent otherwise than according to the wishes of the legislature. The objective here is to ensure the financial and legal accountability of the executive government to the legislature and, within the executive government, to ensure a similar accountability on the part of each subordinate authority to the one immediately above in the hierarchy of delegation.

A Tool for Management : A budget is an operational document and, as such, it serves as a valuable tool for management. The emphasis, in this context, is on projects, programmes and activities for which there is managerial responsibility in terms of cost, time and accomplishment.

[15]Buck, A.E., *op.cit.*, p. 127.

Functional Approach : A classification of the budget on a system of functional lines is one of the important characteristics of a modern budget. Such a classification enables all the items of expenditure in a particular field of activity to be grouped under one functional category, e.g., defence, education, health, establishment expenses, etc., irrespective of the department or the agency which incurs the expenditure actually. It is argued that this gives a clearer picture of the government's effort in each field.

Performance and Accomplishment : Performance or accomplishment is closely allied to the 'a tool for management' objective of the budget, with the emphasis shifted from cash to cost and expenditure and to achievement. The concept and techniques of performance budgeting have developed in the U.S.A. and in a few other countries, and some progress in this direction is also felt in this country.

Coordination and Correlation with the Plan : In the context of planned economic development of an underdeveloped economy, the term 'accountability' acquires a broader and more significant connotation than in its ordinary usage. It does not confine itself to mere verification of due sanction and approved purpose for expenditure incurred by the relevant authorities. It extends to ensuring that annual programmes of development and the due performances and achievements are set out and implemented in relation to the overall and sectoral targets set out in the development Plans. Annual accountability remains, but it becomes a part of a long-run responsibility of the executive government for due execution of the development Plan.

To Facilitate Economic Analysis : In recent years, increased emphasis is being placed on the development of a proper system of budgetary classification of government transactions from the point of view of economic analysis. The budget, it is argued, should bring out the impact of the revenues and other receipts and expenditures of the government on the functioning and behaviour of the national economy as a whole. Such a classification of the budgetary performance should enable the determination of how much of the national income has its origin in government activities, and the extent of capital formation and asset creation as a result of governmental operations. In setting out the budgetary data, therefore, account should be taken of economic categories of significance, viz., consumption expenditure, transfer payments, capital investments, etc.

Instrument of Fiscal Policy : The budget as an instrument of fiscal policy, i.e., a fiscal tool for consciously influencing the operations and directions of an economy, is one of its most important aspects. The structure and levels of taxation and public expenditure alongwith conscious management of public debt which are operated through the budgetary process are among the main devices for persuing economic objectives such as the maintenance of full employment with reasonable growth possibilities in the economically developed countries, and, an accelerated rate of economic growth with stability in underdeveloped economies.

Precisely, besides being the most important annual item on the agenda of the legislature, the budget serves a number of purposes, fiscal, economic and financial, administrative, managerial, developmental, etc., for each State as well as the economy as a whole. It is a document for parliamentary action and an instrument of parliamentary control. It is a management tool and a basis for administrative delegation. It sets out a programme of development and enables the examination of performance. These objectives are not mutually exclusive. There is, however, one over-riding need that has attracted lot of attention quite recently, and it is that all governmental processes—including the budgetary process—should be oriented towards action and performance: action that achieves optimum results, and performance that involves not more than reasonable cost, effort and time.

6

Principles or Canons of Government Budgeting

The canons of government budgeting may be studied under the following heads :

(1) Relationship between 'budgetary system' and the fiscal activities of the executive governments: (a) comprehensiveness, and (b) exclusiveness.

(2) Treatment by the budgetary mechanism of the factors included in the system : (a) unity, (b) specification, (c) annuality, (d) accuracy, and (e) integrity.

(3) Forms and techniques of the presentation of the budget : (a) clarity, and (b) publicity.

Comprehensiveness and Exclusiveness

In a parliamentary democracy all public expenditures and revenues have got to be sanctioned by the legislature and it becomes necessary, therefore, that each item of expenditure and each item of revenue included in the budget should have due sanction. Such a detailed and complete picture of government expenditures and revenues should be presented in the budget that even a common man is able to look through the entire financial position of the government. Comprehensiveness is a well-accepted rule among critics of budgetmaking that "budget should present a complete financial plan"[16] and that it should be considered and acted upon as a whole.

The budget is concerned exclusively with financial operations of the government and as such should confine itself to financial matters.

Unity, Specification, Annuality, Accuracy and Integrity

Unity denotes that all the revenues of the government should be accounted for in a single fund or account wherefrom all the expenditures should be incurred. Further, it means that the estimates in the budget, both on account of revenues and expenditures should be in gross terms, with logical and scientific arrangement of the items of such revenues and expenditures. *Specification* requires, that the sources of revenue and items of expenditure must be specific and subject to easy location and classification. *Annuality* means that a single budget should cover a period of one year normally, and a fresh budget should be prepared and presented to the legislature every year. *Accuracy* involves that the estimates of revenues and expenditure included in the budget must be as accurate as possible. *Integrity* supposes that the schemes/projects/programmes included in the budget to be taken up in the ensuing year must be carried out as provided in the budget and in the spirit the legislature clears them while voting on the items.

Clarity and Publicity

In a democratic political set-up where even the legislatures are to derive their authority from the electorate, the budget should be prepared in such a manner so as to become intelligible even to the layman. The budget should, therefore, be a clearly and lucidly presented informative document and requires wide publicity for the benefit of the electorate.

7

Revenue Budget and Capital Budget

For sometime past, in some countries including India, it has become customary to distinguish between 'revenue budget' and 'capital budget', the former relating to the current financial transactions of the State and the latter involving transactions of a capital nature. In order to make a

[16]Groves, Harold M., *Financing Government*, Fifth Edition. New York : Henry Holt and Company, 1958.

clear distinction between 'revenue budget' and 'capital budget', on the expenditure side, it becomes necessary to distinguish between the consumption or operational expenditure on the one hand and capital or investment expenditure on the other. In India, the expenditures classified as current encompass broadly the defence expenditure, development expenditure financed out of revenue budget, non-development expenditure, interest on public debt, etc., in the Union budget and are financed normally out of tax revenues, earnings of public enterprises and other non-tax revenues of current nature. As regards the revenue budgets of the States, major items of current expenditure are education, provision of medical facilities, civil works, development of agriculture financed out of revenue budget, civil administration, interest on public debt, etc., and are financed normally out of tax revenues, non-tax receipts and statutory grants from the Union government. Capital or investment outlays are included in the capital budget and are, under normal circumstances, financed out of budgetary surpluses from revenue account, borrowings (internal and external), other receipts of a capital nature, and borrowing from the central banking authority.

Whatever be the basis of distinction between the revenue budget and the capital budget, the functional separation of these two types of transactions must be such as to fiacilitate proper control and management of State finances, i.e., it should conform to the requirements of administrative convenience. "There would be a distinction between government expenditure on current account and on capital account. But it would not be an economist's or a statistician's distinction based on an analogy with private accounting. It would be an administrative distinction based upon administrative convenience."[17]

It may be pointed out that, ordinarily, the separation of budget into the 'revenue budget' and 'capital budget' is supported by two main considerations : (a) administrative and management considerations; and (b) economic considerations.

For an efficient financial administration and the effective parliamentary control over it, it becomes desirable that the functioning of the government in its administrative work should clearly be distinguished from its functioning in respect of creation and management of capital projects. The accounts relating to these two types of functions must be segregated in order to separate the operational activities of the government from its developmental activities involving creation and management of capital assets. The need for such a separation becomes still more pronounced in a developing economy like India where public sector

[17]Hicks, J. R., *Problem of Budgetary Reform.* Oxford : Clarendon Press, 1948, pp. 5-6.

investments in development activities have been dominant throughout the period of planned economic development since 1951-52 and have been rising phenominally with successive Five Year Plans.

Moreover, a distinction between 'current' and 'capital' transactions of the government facilitates an analysis of the effects of the revenues and expenditures of the government on the economy. Three types of analysis are important in this connection : (a) the effect of the transactions of the government on current consumption; (b) the effect of government transactions on capital formation; and (c) the inflationary or deflationary trends arising out of such transactions.

8

Economic Classification of the Budget

The budget being a consolidated account of the financial programmes of a government, it should be prepared and presented in a manner as to ensure not only the internal coordination and comparability of different financial programmes, but also to allow an analysis of their economic implications. "The different items of Government expenditure are somewhat dissimilar in their economic significance. A part of Government expenditure, for example, is for the purchase of goods and services and is in the nature of a direct draft on the real resources of the community. Another part of Government expenditure consists of unilateral transfers in the form of grants and subsidies and adds to the purchasing power of the rest of the community. The expenditure on goods, services and unilateral transfers may again be distinguished from expenditure by way of loans or on repayment of debt which changes the net financial claims of the Government against the rest of the economy. Similar distinctions may be drawn between items of Government receipts. Again, in some contexts, and especially from the point of view of development, it may be desirable to look at only a part of the totality of Government transactions, e.g., at Government expenditure for capital formation and its financing. These and various other magnitudes relevant to economic analysis and interpretation cannot be readily disentangled from the budget without a rearrangement or reclassification of Government transactions."[18]

It is usual now to supplement the conventional classification of items with another classification based on the economic character of the items. Therefore, the formulation of the budget must be based on two

[18]Government of India (Ministry of Finance), *An Economic Classification of the Central Government Budget for 1957-58*. New Delhi, p. 1.

distinct objectives : (a) to act as a major device of executive execution and the control of the legislature on such execution; and (b) should be sufficiently informative for an economic analysis and for the formulation of economic policy.

Such a manner of classification and its analysis provides, therefore, crucial information for a proper formulation of the economic policy of the government, more particularly in regard to the government initiated and government oriented promotion of economic development with stability. A proper economic classification of the budget followed by a scientific analysis enables the government to evaluate the short-term effects of government transactions in relation to long-term and broader economic objectives, such as maintenance of sustained full employment with price stability in the modern highly industrialized private enterprise economies and an accelerated rate of economic growth with stability in the underdeveloped countries.

"There is, of course, no single or unique system of classification which can bring out the full economic significance of all Government payments and receipts. A classification of Government accounts can only provide a quantitative measure of cartain categories the significance of which is derived from the manner in which they are defined and the way in which they are related to a specific framework of economic analysis. One such framework which has been used extensively in many countries in recent years is a system of national income and expenditure accounts which portray the activities associated with the generation of the total national product and its disposal between consumption and capital formation. To the extent that the classification of Government transactions is attempted in a manner which makes it possible to link them with a system of national income and expenditure accounts, it would be possible to indicate the share of Government in the generation of the national product and in national expenditure, the breakdown of Government expenditure into consumption and capital formation and the impact of Government transactions on the level and pattern of expenditure of the rest of the economy."[19] The need for providing a link with a system of national income and expenditure accounts was kept in view in the economic classification of the budget estimates of the Government of India with effect from the estimates for the financial year 1957-58.

At the same time, the classification presented in the economic classification of the Union budget is not limited strictly to the requirements of national income accounting. Details of transactions in financial assets and liabilities, for example, are not strictly relevant or necessary for a system of national or social accounts. These details, however, are

[19] *Ibid.*, pp. 1-2.

presented in the classification attempted in as much as they are significant in themselves. "The technique of interpreting economic phenomena in terms of changes in the composition and ownership of financial assets has received considerable attention in recent years and the usefulness of economic classification of the budget would be enhanced to the extent that it brings together the broad picture of borrowing and lending transactions. An analysis of financial transactions is also important in that it gives an indication of the indirect contribution of the Central government to capital formation by way of loans to the State governments and to other agencies."[20]

The economic classification of the budget of the Government of India is attempted in terms of six accounts:[21]

Account 1 : Transactions in commodities and services and transfers : Current Account of Government Administration.

Account 2 : Transactions in commodities and services and transfers : Current Account of Departmental Commercial Undertakings.

Account 3 : Transactions in commodities and services and transfers. Capital Account of Government Administration and Departmental Commercial Undertakings (Combined).

Account 4 : Changes in the financial assets : Capital Account of Government Administration and Departmental Commercial Undertakings.

Account 5 : Changes in financial liabilities : Capital Account of Government Administration and Departmental Commercial Undertakings.

Account 6 : Cash and Capital Reconciliation Account of Government Administration and Departmental Commercial Undertakings.

The above system of classification is based on a series of distinctions. A distinction is drawn, *first*, between transactions in goods, services and transfers (Accounts 1 to 3) and financial transactions which affect the net claims of government on the rest of the economy (Accounts 4 to 6). The transactions in goods and services and transfers are again divided into current transactions (Accounts 1 and 2) and capital transactions (Account 3). Similarly, a distinction is drawn between the current transactions of government administration (Account 1) and current transactions of departmental commercial undertakings (Account 2).

The framework of this classification is briefly explained below :

Account 1 : Current Account (Administration)

In analysing government transactions, it is useful to distinguish

[20] *Ibid.*,

[21] *Ibid.*, pp. 2-9.

between the activities of government administration and those of government commercial undertakings. The latter are primarily engaged in the production (or distribution) of goods and services for sale to other sectors of the economy in the same manner as other productive sectors of the economy, and thus assist in the generation of the national product. The administrative departments of the government, on the other hand, merely act on behalf of the community as a whole, expending a part of the national product transferred from the community. Account 1 is concerned with the current receipts and expenditures of government administrative departments. It sets out the final outlay of government (on current account) which is a charge on the national product and represents direct consumption by government administrative departments. The final outlays are made up of purchases of commodities and services, and wage and salary payments. Apart from its own direct expenditures, government makes transfer payments—in the shape of reliefs, scholarships, grants, subsidies—to the rest of the economy, which add to the disposable income of the community. To meet all these expenditures, however, the government appropriates a part of the community's income through a variety of taxes and other receipts accruing in the course of administration. In addition, government has an investment income from public enterprises and real estate. The balance of revenue—after meeting current expenditure and transfers—gives the saving on government account, available for capital account.

Account 2 : Current Account (Departmental Commercial Undertakings)

The operations of departmental commercial undertakings are of the nature of 'producer activities' of the government. The expenditures incurred by these undertakings on purchase of materials, etc., are quite different in character from final outlays of administrative departments. Similarly, sale proceeds of commercial undertakings are different from the transfer receipts (like taxes) of administration. This Account, therefore, sets out what is generally known as the profit and loss account of the departmental commercial undertakings, and is different in character from Account 1.

The retained profits of commercial undertakings together with savings of government administration form total savings of the public sector for capital formation. From the economic point of view, it is this magnitude, namely, the surplus on current account which links up with private savings in a scheme of national income accounts. In the scheme of economic classification of the transactions of the Union government, undertakings run independently (government companies or corporations) have not been included. Only undertakings run departmentally are included in the scheme.

Account 3 : Capital Account : Transactions in Commodities and Services and Transfers (Administration and Departmental Commercial Undertakings)

This account is concerned with the total capital outlay—representing physical asset formation—by administration and departmental commercial undertakings, and with unilateral transfers of capital. In this account, the physical asset formation by government has been shown in terms of gross and net asset formation, and net increase in inventories. In case of inventories, a distinction has been drawn between inventories required for construction jobs and for commercial undertakings and inventories of strategic materials like food and steel held for policy reasons. Transfers of capital are also split up between grants to other sectors for capital formation and miscellaneous items of transfer of a capital nature. Among transfer receipts, foreign grants are shown separately. To the extent the government capital formation as defined in this account exceeds government saving—as brought over from Accounts 1 and 2—there is an expansionary stimulus given to the economy as a result of government's budgetary operations. The difference between government savings and government capital formation is often used in economic analysis as a measure of budgetary deficit. The difference between total government expenditure on goods, services and transfers and the receipts from transfers, profit and property income of government provides another measure of budgetary deficit.

Account 4 : Capital Transactions : Changes in Financial Assets (Administration and Departmental Commercial Undertakings)

This account is concerned with transactions in financial assets. In other words, with financial investments in industrial and commercial concerns (i.e., investment in shares) and loans and advances granted to the rest of the economy. Loans made for capital formation and loans made for other purposes are shown separately. The balancing item of Account 4, representing the net financial investments, loans and advances of the Central government, adds to the deficit in Account 3 to give the total requirements of finance to be met out of borrowing or by adjustment in government cash balances.

Account 5 : Capital Account : Changes in Financial Liabilities (Administration and Departmental Commercial Undertakings)

In this account are recorded the borrowing operations of the government including borrowings from the Reserve Bank of India. The issue of one rupee currency notes is also shown, because its economic effect is the same as that of borrowing from the Reserve Bank of India. The deficits in Accounts 3 and 4 represent the net amount of financial resources required by the Central government—over and above its transfer and miscellaneous receipts to cover all its consumption and capital outlays, transfers and loans, etc., to the rest of the economy. This account is concerned with the provision of finance for meeting the excess of outlays—real and financial—over revenues; and elaborate gross borrowing of the Central government, with details of different kinds of borrowings. The balancing item in Account 5 gives the net increase in the financial liability of the Central government to the rest of the economy; in other words, the net borrowing of the government, including borrowing from the Reserve Bank of India.

Account 6 : Cash and Capital Reconciliation Account (Administration and Departmental Commercial Undertakings)

Account 6 is the Reconciliation Account summing up the net position in respect of Accounts 3, 4 and 5 showing the effect of all transactions of the Central government on its cash position.

From the framework of the economic classification of the Union budget, it will be observed that only the expenditures of the Union government and the commercial undertakings run by it departmentally have been taken into account. However, for the proper appreciation of the government's role in the generation of income, savings and capital formation in a comprehensive way, it is essential that the analysis should be extended so as to cover the budgets of all the State governments, statutory public sector undertakings, and the government companies. Presently, only a few State governments bring out an economic classification of their budgets.

The economic classification of the budget now issued is a supplementary budgetary document and as such does not play any specific role in the formulation of the budget. It is important that the economic classification be integrated into the budgetary process itself. For this, the economic analysis of the estimates should be carried out in each Ministry/Department for each Demand so that they could be analysed, at the time of consolidating the various Demands, from the point of view of assessing the total impact of the magnitude of expenditure in a particular year.

"The usefulness of the technique of economic classification has to be judged not only in terms of a better economic understanding of government operations but also in terms of how far it facilitates policy formulation. The data in India in this regard are still deficient. For example, we have as yet no official series of savings and investment."[22] The recommendations of the Administrative Reforms Commission in this regard are : (1) Economic classification should be extended to the budgets of the State governments and to all the non-departmental public sector undertakings; and (2) the economic classification should be integrated with the budgetary process itself and to every demand for grant there should be attached an economic classification of that particular demand.[23]

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[22]Administrative Reforms Commission, *Report of the Study Team on Financial Administration*, New Delhi, May 1967, p. 32.

[23]Administrative Reforms Commission, *Report on Finance, Accounts and Audit*, New Delhi, January 1968, p. 22.

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5

The Budget: General Considerations and the Preparation

Some General Considerations

Before an attempt is made to consider the budgetary system as it obtains in India, it would be proper to deal with certain fundamental principles of the system, some normal features of the budget, and certain notations used therein. The Indian Constitution, adopting the fundamental principles governing the British financial system, provides for the parliamentary control over the receipts and disbursements of public moneys. These fundamental principles of the system can be outlined in the form of four propositions:[1]

(1) *Parliamentary or legislative control over taxation.* No tax can be imposed except with the authority of the legislature.

(2) *Parliamentary or legislative control over expenditure.* No expenditure can be incurred except with the sanction of the legislature.

(3) *Financial initiative of the executive government.* No tax can be imposed or expenditure sanctioned unless initiated and asked for by the executive government.

(4) *Principle of annuality.* All expenditure, except those specifically

[1]Mukherjea, A.R., *Parliamentary Procedure in India*, Second Edition, Calcutta: Oxford University Press, 1967, pp. 277-281.

charged by any enactment, requires to be sanctioned on an annual basis.

No tax can be imposed except with the authority of the legislature

According to Article 265 of the Constitution, "no tax shall be levied or collected except by authority of law." All tax proposals of the executive government would, therefore, have to be presented before the legislature in the form of bills to be passed into law, and unless the authority to levy taxes is sanctioned in the form of an Act, no tax can be levied and the proceeds collected.

Another pertinent question which arises in this connection is : Can tax be levied and the proceeds collected under the authority of an Ordinance under the Ordinance-making powers of the executive government ? Legally, an Ordinance has an equivalent effect as that of an Act of the legislature. "Strictly speaking, therefore, an Ordinance is also law under the authority of which any tax can be levied or collected. But having regard to the fundamental constitutional principle that there can be no taxation without representation, such a course would seem to be at least unconstitutional. It may be said that an Ordinance must be laid before the legislature and would expire unless enacted into law by it. Therefore, no permanent taxation can be imposed by an Ordinance. But it would be possible to levy an *ad hoc* tax without any sanction of the legislature."[2]

No expenditure can be incurred except with the sanction of the legislature

Article 266 of the Constitution provides that all revenues received, all loans raised by the issue of treasury bills, loans or ways and means advances, and all moneys received in repayment of loans by the Union or the State shall form one consolidated fund to be entitled the Consolidated Fund of India or the Consolidated Fund of the State, as the case may be, and that no money can be withdrawn out of that Fund except in accordance with law and for the purpose and in the manner provided for in the Constitution. All moneys received by the State, with the exception of certain deposits into the Public Accounts, thus go into the Consolidated Fund, and no money can be withdrawn therefrom except under appropriation[3] made by law, i.e., on introducing a bill after grants have been made by the Lok Sabha or the Vidhan Sabha, as the case may

[2] *Ibid*, p. 278.

[3] Appropriation is the application of money for expenditure on a service specifically named, the issue of the money being legally authorised by the law which also specifies the optimum limits of expenditure and issue for such service.

be, and necessarily completing all subsequent stages involved in the passing of the bill and its assent by the Head of the State.

An important question arises here. Can appropriation be made under an Ordinance ? In the context of the provisions laid down in the Articles 114, 204 and 266 of the Constitution, it would appear that appropriations by Ordinance promulgated by the President will not be warranted by the Constitutional provisions. The Constitution has, however, made an exception in Article 357(1) (c) which provides that, during an emergency, the President is empowered to authorize expenditure from the Consolidated Fund of a State, pending the sanction of such expenditure by the Parliament. Such power is exercisable by the President only on the failure of the constitutional machinery in the State, the powers of the State legislature being exercised by or under the authority of the Parliament and Lok Sabha not being in session at the time.

No tax can be imposed or expenditure sanctioned unless asked for by the executive government

The initiative for taxation or expenditure lies with the executive and the legislature cannot act in these matters *suo motu.* Articles 117 and 207 of the Constitution provide that no bill imposing tax can be introduced in the legislature except on the recommendations of the President or the Governor, i.e., the President or the Governor as advised by the Council of Ministers, that is the executive government. Obviously, no such bill can be introduced by any member or a group of members of the legislature.

Articles 113 and 203 provide similarly that no demands for grant of any money for expenditure can be made except on the recommendations of the President or the Governor, as the case may be.

All expenditure except that specifically charged by an enactment requires to be sanctioned on an anual basis

Expenditure of public funds has been classified as: charged and voted. In the case of charged expenditure, no demands for grants need be made to the legislature as no sanction of the legislature is necessary for incurring such expenditure. In case of voted expenditure, however, demands for grants have to be made to, and sanction obtained of, the legislature.

According to the provisions of Articles 112 and 202, the estimates of expenditure for any financial year, which in India commences with effect from 1st April, has to be presented to the legislature and the sanction of the expenditure is given on that basis, i.e., on an annual basis. Grants are thus sanctioned for a period of one year and the amount unspent at the end of the year lapses.

"The control over expenditure therefore is exercised through the provisions of the Costitution under which an annual estimate of the receipts and expenditure has to be presented to the legislature; money required has to be granted under demands and withdrawal of money out of the Consolidated Fund and appropriation for the various services have to be authorized by an Act (Articles 113,114,203 and 204). Further control is exercised by the legislature when the accounts audited by the Comptroller and Auditor General come before the legislature (Article 151) and are examined by the Public Accounts Committee."[4]

2

Some Important Terms Usually Used in Connection With Budgeting

There are certain important terms which are usually used in connection with budgeting and its procedure. Before a detailed analysis of the budgetary procedure, as it obtains in India, is taken up, it would be worthwhile to attempt some brief explanations of these terms in the succeeding paragraphs.

The Consolidated Fund, the Contingency Fund and the Public Account

Article 266 (1) of the Constitution provides for the creation and maintenance of a Consolidated Fund for the Union, known as the Consolidated Fund of India. The Consolidated Fund is a reservoir into which all the revenues raised by the Union government, proceeds of all loans raised by the issue of treasury bills, market loans, ways and means advances, all moneys received by the government in repayment of loans flow and from whieh all expenditures issue. The institution of the Consolidated Fund is, therefore, a device for consolidating at one place and having a full view of all the moneys available for a particular year which is to be apportioned according to the mode of appropriations sanctioned by the legislature. No moneys can be issued out of this Fund except in accordance with a valid law made by the Parliament [Article 266 (3)].

Circumstances may sometimes arise when it may become necessary

[4]Mukherjea, A.R., *op.cit.*, p. 282.

to incur expenditure in an emergency *or* in excess of moneys granted for any service in anticipation of the sanction of the legislature by a supplementary grant. "No government can foresee all possible demands during the currency of a year and provide for them in the Appropriation Act. The executive departments would be greatly hampered in the discharge of their duties if they had to await the sanction of the legislature before incurring unforeseen, but unavoidable, expenditure. At the same time if the expenditure is incurred without parliamentary sanction it is illegal."[5] In order to provide for this, Article 267 (1) of the Constitution provides that the Parliament may by law establish a Contingency Fund in the nature of an imprest to be entitled 'the Contingency Fund of India' into which shall be paid from time to time such sums as may be determined by such law, and the said Fund shall be placed at the disposal of the President to enable advances to be made by him out of such Fund for the purposes of meeting unforeseen expenditure pending its authorization by Parliament by law under Article 115 or Article 116.

The Contingency Fund of India Act was enacted in 1950 which provided for the establishment of a 'Contingency Fund of India' into which shall be paid, from and out of the 'Consolidated Fund of India' a sum of fifteen crores of rupees. The Contingency Fund of India was to be held by a Secretary to the Government of India in the Ministry of Finance on behalf of the President. It was provided further that no advance shall be made out of such Fund except for the purpose of meeting unforeseen expenditure pending authorization of such expenditure by the the Parliament under appropriation made by law. "The existence of a contingency fund does not obsolve the Executive from the duty of submitting such expenditure to the legislature for sanction, nor does it commit the legislature to approving the expenditure, simply because it has been met out of the Contingency Fund. Parliamentary control over the expenditure is thus in no way diminished by the creation of the Fund."[6] For the purpose of carrying out the objects of this Act, the Union government may make rules, regulating all matters connected with or ancillary to the custody of, the payment of moneys into and the withdrawal of moneys from the Contingency Fund of India.

Apart from moneys which are paid into the Consolidated Fund, certain other moneys are received by the government, e.g., State Provident Funds, various pre-deposits under the income tax, depreciation and reserve funds of departmental undertakings like Railways and Posts and Telegraphs, etc., and are paid into the Public Account. The Public

[5] Wattal, P.K., *Parliamentary Financial Control in India*, Second Edition. Bombay: Minerva Book Shop, 1962, pp. 72-73.

[6] *Ibid.*, p. 73.

Account is the Fund, therefore, to which all public moneys received by or on behalf of the government are credited with the exception of : (a) all revenues received by the government; (b) all loans raised by the government by way of loans, treasury bills, *or* ways and means advances; and (c) all moneys received by the government in repayment of loans. In other words all public moneys, other than those credited to the Consolidated Fund *or* the Contingency Fund, which are received by *or* on behalf of the government are credited to the Public Account. For payments out of the Public Account, no demand is required to be presented to the Parliament, and the actual requirements are met, from time to time, as they arise. These payments are largely in the nature of banking transactions.

All moneys, whether paid into the Consolidated Fund, the Contingency Fund, or the Public Account, are held by the Reserve Bank of India in the accounts in the name of the Central or the State government. All governments, Central or State, are obliged to deposit all cash balances, free of interest, with the Reserve Bank of India. Where, however, the Reserve Bank of India is not established, the governments, ordinarily, keep their accounts with the State Bank of India and its subsidiaries. At other places government treasuries are kept for the purpose.[7]

Under the agreements between the Reserve Bank of India and the various governments, the Reserve Bank of India agrees to make ways and means advances upto a certain limit to the governments.

Expenditure Charged upon the Consolidated Fund of India

Under Article 112(3) of the Constitution the following expenditure has been declared to be the expenditure charged upon the Consolidated Fund of India :

(a) the emoluments and allowances of the President and other expenditure relating to this office;

(b) salaries and allowances of the Chairman and Deputy Chairman of the Rajya Sabha; and the Speaker and Deputy Speaker of the Lok Sabha;

(c) debt charges for which the Government of India is liable including interest, sinking fund charges and redemption charges and expenditure relating to the raising of loans and the service and redemption of debt;

(d) salaries, allowances and pensions payable to or in respect of the Judges of the Supreme Court; Chairman and the Members of

[7] *Reserve Bank of India Act, 1934*, Sec. 21.

the Union Public Service Commission; pensions payable to or in respect of the Judges of the Federal Court; and pensions payable to the Judges of the High Court;

(e) salary, allowances and pension payable to or in respect of the Comptroller and Auditor General of India;

(f) any sums required to satisfy any judgement, decree or award of any Court or arbitration tribunal; and

(g) any other expenditure declared by the Constitution or by the Parliament to be so charged.

The other expenditures declared by the Constitution to be so charged are : (1) the administrative expenses of the Supreme Court, including all salaries, allowances and pensions payable to or in respect of officers and servants of the Court—Article 146(3); (2) the administrative expences of the office of the Comptroller and Auditor General including all salaries, allowances and pensions payable to or in respect of persons serving in that office—Article 148(6); (3) the expenses of the Union Public Service Commission including any salaries, allowances and pensions payable to or in respect of the members or staff of the Commission—Article 322; and certain other expenditures.

It may, however, be noted that the amount of emoluments and pensions referred to under (a), (b), (d) and (e) are not fixed by the Constitution but by legal enactment. The estimates are arranged by suitable sub-heads, which indicate broadly the categories of expenditure included in the demand.

The expenditure charged upon the Consolidated Fund of India, it may be seen, is in the nature of obligatory payment. The charged items of expenditure are not subject to vote of the Parliament, though the amounts proposed to be spent in any year have to be included in the budget.

The Money Bill and the Financial Bill

Bills which may contain financial provisions are of two classes : (1) 'money bills' as defined in Articles 110 and 199 of the Constitution, and (2) other bills containing financial provisions, which may be called 'financial bills'.

A bill shall be deemed to be a 'money bill' when it contains only provisions having a bearing upon all or any of the following :

(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 or the amendment of the la ≥

with respect to any financial obligations undertaken or to be undertaken by the government;

(c) the custody of the Consolidated Fund or the Contingency Fund, the payments of money into or withdrawal of moneys from any such Fund;

(d) the appropriation of moneys out of the Consolidated Fund;

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

(f) the receipt of money on account of the Consolidated Fund or the Public Account, *or*, the custody or issue of such money, *or*, the audit of the accounts of the government; and

(g) any matter incidental to any of those specified above.

A 'money bill' does not however, include imposition of fines or demand of fees for licence or imposition, abolition, and remission of any tax by a local authority for local purposes. An appropriation bill which does not impose any tax or devise the amount sought to be withdrawn from the Consolidated Fund is not a 'money bill'.[8]

There are two restrictions in regard to 'money bills' : (a) they cannot be introduced in the Upper House, and (b) they cannot be introduced without the recommendations of the Head of the State.[9] The powers of the Upper House are also limited in regard to 'money bills'. A 'money bill' after it has been passed by the Lower House is transmitted to the Upper House for its consideration and recommendation. The Upper House has no right to amend a 'money bill'; but it can recommend to the Lower House that certain amendments be made.[10]

Three other classes of bills involving financial matters have been excluded from the category of 'money bills' :

(a) bills which provide for the imposition of fines or other pecuniary penalties;

(b) bills which provide for the demand or payment of fees for licences or fees for services rendered;

(c) bills which provide for the imposition, abolition, remission, alteration or regulation of any tax by way of local authority or body for local purposes.[11]

Financial bills cannot be introduced without the recommendation of the Head of the State and cannot be introduced in the Upper House.

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[8] *Lok Sabha Debates*, 1957, Vol. X, c. 5617.

[9] Articles 109, 117, 198 and 207.

[10] Articles 109 and 198.

[11] Articles 110 and 199.

Such bills can, however, be amended by the Upper House, as Articles 109 and 198 apply only to 'money bills' defined under Articles 110 and 199.

Ad-hoc Funds

The executive government has been authorised to set up *ad hoc* Funds for special purposes such as the General Development Fund. When an amount is transferred to any such Fund, it is treated as expenditure in the estimates of the year in which the transfer is made. Expenditure under different heads, met from these Funds, is shown in the estimates of the year in which they are incurred and an equivalent amount is transferred to the Fund from the expenditure head. However, the sanction of the President is required to any appropriation from revenue to create such a Fund and similar approvals shall be required for financing subsequent expenditures from such Funds.

Demands for Grants

All expenditure, out of the Consolidated Fund, is provided in Demands for Grants. These demands generally cover the requirements of each individual administrative service. A Ministry, for example, will have its demands for the expenditure of the Ministry and one each for the expenditure of each of the various departments under its administrative control.

The estimates of expenditure have to be shown under two heads : (a) expenditure charged upon the Consolidated Fund, and (b) other demands for grants. Only the second category of expenditure is presented for vote of the legislature.

Within each demand, the estimated expenditure is arranged, *firstly*, under major heads, if there are more than one, and *secondly*, under suitable sub-heads, indicating broadly the categories of expenditure included in the demand. As far as the total demand granted is not exceeded, the executive government, and the authorities subordinate to them whom the powers may be delegated, can meet excess expenditure under one sub-head from saving affected from other(s) with the exception that excess expenditure under the head 'charged expenditure' cannot be met by saving under 'voted heads' and vice versa.

Supplementary, Additional or Excess Grants

Quite often it becomes necessary to approach the legislature for supplementary grants:

(1) if the amount authorized by the Appropriation Act to be expended for a particular subject for the current financial year is found to be insufficient; *or*

(2) if a need has arisen during current financial year for supplementary or additional expenditure on a new subject which was not provided in the budget; *or*

(3) if for any reason, money has been spent on a subject during a financial year in excess of the amount granted in the budget for that year.

For such supplementary, additional *or* excess grants, the President causes to be laid before both the Houses of Parliament another statement, showing the estimated amount of such expenditure or causes to be presented to the Lok Sabha a demand for such excess, as the case may be.[12]

Vote on Account, Vote of Credit and Exceptional Grants

It has been stated earlier that no money can be withdrawn from the Consolidated Fund without the sanction of the legislature. As sanction is given on annual basis, the budget for the next year must be passed and the necessary moneys granted before the expiry of the current financial year so that when starting the expenditure for the next year, it should have a proper sanction. If the Appropriation Bill is not passed by 31st March, the expiry date of the financial year, what is done in order to regularise the expenditure is to vote in lump a portion of the estimates so that the administration can be carried on. The procedure is known as a 'vote on account' and is authorised by the Constitution.[13] The Constitution provides further that an Appropriation Act should be passed even on a 'vote on account'.[14]

The Constitution[15] provides further that the legislature can make a grant for meeting an unexpected demand upon the resources of India when, on account of the magnitude or the indefinite character of the service, the demand cannot be stated with the details ordinarily given in an annual financial statement. Such a grant is known as 'vote of credit' and an Appropriation Act is necessary also in the case of a 'vote of credit'.

The Constitution[16] provides that the legislature can make an exceptional grant which forms no part of the current service of any financial year. Such a grant is known as 'exceptional grant'. The procedure for the main estimate, including the passing of an Appropriation Bill, is necessary for exceptional grant also.

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[12]Article 115(1).

[13]Articles 116 and 206.

[14]*Ibid.*

[15]*Ibid.*

[16]*Ibid.*

Token Grant

When money is available from the sum already sanctioned on a grant or from some other source (e.g., a loan raised by the executive government), but it is necessary to obtain sanction of the legislature, it is customary to demand a nominal sum of Re. 1 which is known as a token grant. When money has been sanctioned for a particular purpose included in a grant, but the savings from such a purpose are proposed to be spent for some other purpose, also within the grant though not similar, it is usual to acquaint the legislature about such appropriations and obtain legislative sanction by means of a 'token grant' on a supplementary estimate.

3

Procedure of Government Budgeting

Normally, there are five stages in the budgetary procedure : (1) preparation of the budget; (2) budget in the legislature—presentation, discussion and sanction; (3) execution of the budget; (4)national accounting; and (5) audit. In India, functions (1) and (3) are the responsibilities of the executive government; function (2) lies within the competence of the legislature; and function (4) and (5), with the exception of some decentralization of the maintenance of accounts, are performed by the Comptroller and Auditor General of India. In this Chapter, a discussion on the procedure of the preparation of the budget in this country would be attempted; but before that let us first take up the normal features of a budget.[17]

Normal Features of a Budget

The budget system, it will be observed, is the means by which financial administration is expressed broadly; and, therefore, what has been said about the general characteristics of a good system of financial administration applies equally to the budget system. The budget system, consequently, must provide for unity and centralisation; for control at all stages of budget procedure; for simplicity, promptness, regularity; and for efficiency of functioning. Obviously, the budget should be characterised by the following :

[17]In the present book, the discussion on the budgetary system in India will be confined to the procedure as is applicable to the budget of the Union government. The procedure relating to the budgets of the States is more or less similar to that which obtains at the Union level.

(1) *The estimates should be on cash basis.* The budget should be prepared on the basis of what is expected to be actually received or paid, under sanction of the legislature during the current financial year and the arrears of past years, and not for demands or liabilities falling due within the year. Consequently, the budget is an estimate of cash receipts and cash payments during the financial year to which it relates, notwithstanding the fact that such receipts and payments relate to that year or previous year(s).

(2) *One budget for all financial transactions.* Separate budgets for administrative departments or preparation and presentation of extraordinary budgets for special purposes obscure the true financial position of the State and make it difficult to coordinate the financial activities of the various departments so as to assess the real surplus or deficit on the whole. Accordingly, a sound principle of financial administration is that there should be one budget for all financial transactions of the government for the year. The aforesaid criterion, however, applies to administrative departments, and not to the departmental commercial and industrial undertakings like Railways in India for which separate budgets are considered both necessary and expeditious.

(3) *Budgeting should be gross and not net.* The gross transactions in the case of both receipts and charges in each department should be entered separately estimating the receipts on the receipt side of the budget and the expenditure on the expenditure side, i.e., to deduct receipts from charges or vice versa and frame the budget for net receipts or expenditure is not allowed. The provision is necessitated because in the absence of such a procedure, the legislature would lose its control over the expenditure of the government which has considerable receipts for meeting expenditure and approaches the former for grants only for that amount of the expenditure which the latter cannot meet from such receipts.

(4) *Estimating should be close.* The general tendency among the persons responsible for estimation of the budget proposals is to underestimate the revenue and over-estimate the expenditure. To a certain extent this tendency may be natural and prudent, but the budgeting should be as close as possible so as to assure the legislature that more money is not taken away from the tax payer than is absolutely necessary for the requirements. Obviously, this would be the case if the underestimation of revenue and the over-estimation of expenditure is out of proportion. Moreover, the Ministry of Finance should also be interested to ensure that the administrative departments do not get more funds than what they really need, for if a department is alloted funds which are an over-estimate and accordingly they would not be spent, the other useful schemes with other departments may be unnecessarily starved of financial

allocation. "Close budgeting means also that the services for which provision has been made out, the particular items included in any vote should be specified and there should be no demands for lumpsums under any head, which the executive may be at liberty to allot after the budget has been voted, for any purpose it pleases."[18]

(5) *The budget should be on annual basis.* Barring for exceptions, almost in all modern economies, the budgets are voted for one year. *Firstly*, a year corresponds with the customary measure of human estimation, and *secondly*, a year appears to be the maximum period for which legislatures can afford to give financial sanctions to the executive and the minimum time which the executive needs to execute the budget effectively.

(6) *The rule of lapse.* All appropriations voted by the legislature expire at the close of the financial year as "no portion unexpended during the year may be reserved or appropriated by transfer to deposits or any other head, or drawn and kept in the cash chest to obviate the lapsing of the grant and to be expended after the end of the year for which the grant was made. This is known as the 'rule of the lapse'."[19] Although the rule prevents economical planning of expenditure over a long period and also leads to what is known as 'rush of expenditure at the end of the financial year', the financial control would become impossible if the administrative departments were permitted to spend, in any year, unutilised savings of previous years in addition to the grants voted for that particular year. Moreover, any advice for rendering grants non-lapsing by withdrawing amounts to a fund outside the Consolidated Fund is contrary to the very fundamentals of parliamentary control and proper financial discipline.

In India, in order to avoid the abnormal rush of payments towards the close of the financial year, the administrative Ministries had been advised by the Union Ministry of Finance that, wherever grants have not been used to the full extent for valid reasons, the Finance Ministry would be prepared to consider proposals to allot provision for the unexpended amounts either in the original budget of the coming year or by means of supplementary grants in that year provided the purposes for which these amounts were originally included in the sanctioned grants continue to be operative. It is hoped that with this assurance the Ministries concerned would take positive steps to prevent the rush of expenditure in the closing

[18]Wattal, P.K., *op.cit.*, p. 49. Block grants, as they are called, are very convenient to the Executive which knows that it will require money for various schemes during the coming year, but cannot afford the interval necessary to prepare the meticulous specification of every rupee of expenditure for a particular purpose.

[19]*Ibid.*, p. 50.

months of the year, and also to refrain from making purchases in a hurry merely to avoid lapse of grants.[20]

(7) Form of estimates to correspond to the accounts. It is essential that, for an easy understanding and proper financial control, the form of estimates should conform to that of national accounts. In India, the rules for the conduct of business in Parliament provide that the budget shall be presented to Parliament in such form as the Finance Minister may, after considering the suggestions (if any) of the Estimates Committee, settle.

(8) Estimates to be prepared on departmental basis. Each Ministry/ Department should estimate for the whole receipts and payments with which it deals finally, irrespective of the fact that such receipt or charge is on account of another Ministry/Department.

4

The Preparation of the Union Budget

The preparation of the budget estimates is the first step towards the financial administration of any country. Viewed from the authority responsible for preparing the budget, the budget can be classified into three categories : (a) legislative type, (b) executive type, and (c) board *or* commission type. Legislative type of budget is prepared ordinarily by a Committee of legislature on the request of the executive. Since it is the legislature which prepares the budget as well as approves it, this type of budget gives more importance to the legislature than the executive. It is doubtful, however, if the legislature would command the necessary competence in order to prepare a budget as the requirements of various Ministries/Departments could best be known only to the executive. As regards the executive type of budget, in almost all the countries who have adopted a system of parliamentary democracy, this type of budget is in vogue. After the budget is approved by the legislature, the executive becomes responsible for its execution. The board *or* commission type of budget is one which is prepared by a board *or* commission consisting wholly of administrative officers or of administrative and legislative representatives jointly. The system is prevalent in some of the States in the United States of America and in some municipal governments.

Of all the agencies which can possibly be charged with the responsibility of the preparation of the budget, the executive should be the

[20]Government of India, Ministry of Finance, Office Memorandum No. 14(3)—B/57 dated October 10, 1957. The instructions were repeated in the Office Memorandum dated September 12, 1960.

fittest body. "The Executive alone can and should do this work. Situated at the centre of government, reaching through its hierarchical organisation to the smallest unit, the executive more than anybody else is in a position to feel public needs and wishes, to appreciate their comparative merits and accordingly to calculate, in the budget, a just appropriation which each of these needs and wishes deserves. Others may know certain details as well possibly better than the Executive, but nobody can have so extensive and impartial a view of the mass of these details, and no one can compromise the conflicting interests with so much competence and precision. Moreover, the Executive charged with the execution of the budget, is compelled, through concern as to its future responsibility, to prepare as well execute the plan."[21] According to another authority, "the responsibility for preparing the budget falls upon the executive, a procedure which is quite universally approved among the critics. Public opinion ordinarily holds the chief executive responsible for the financial success and failure of the administration, although he may have little control over either the receipts or the expenditures. The executive is in the best position to view the financial problem as a whole and to assume the responsibilities for the success and failure of a financial programme."[22]

There is a general agreement, therefore, that the preparation of the budget should be the responsibility of the executive government. In India, as in any other democratic country where the budgetary system has been adopted, the same principle is followed and there is a clear provision in the financial codes that the responsibility for the preparation of the budget estimates lies on the executive government. The task relating to the preparation of the budget is carried on by four agencies: (1) the Ministry of Finance; (2) the administrative Ministries/Departments; (3) the Planning Commission; and (4) the Comptroller and Auditor General of India. India adopted a system of planning for economic development since 1951-52, and since a major portion of investment activity is undertaken in the public sector, while regarding the budget, particularly the capital budget, the Ministry of Finance has to be in close touch with the Planning Commission in order to incorporate in the budget the plan priorities. As the preparation of the budget requires accounting skill as well, the Comptroller and Auditor General of India also comes into the picture.

In India, the 'Annual Financial Statement' laid before both the Houses of Parliament in accordance with the provisions of the Constitution constitutes the budget of the Indian Union. This statement covers all

[21]Stourm, Rene, *The Budget*, translated from seventh edition by Thaddeus Plozinski. New York : D. Appleton and Co., 1917, p. 54.

[22]Groves, Harold M., *Financing Government*, Fifth Edition. New York : Henry Holt and Co., 1958, p. 387.

the transactions of the Union government during the current and the budget years. The budget of the Indian Railways is separately presented to the Parliament and dealt by it. But as the receipts and expenditure of the Railways are, nevertheless, the receipts and expenditure of the Union government, the figures relating to those are also included in lump in the above statement.

The Annual Financial Statement is prepared by Major Heads of Accounts, such heads of accounts falling either under the Consolidated Fund or in the Public Account of the government. The receipts and expenditure of government fall under one or other major heads either in the Consolidated Fund or the Public Account in accordance with the prescribed rules of classification.

The estimates of expenditure show separately : (a) the sums required to meet expenditure which the Constitution has 'charged' upon the Consolidated Fund of India (this expenditure is obligatory and, therefore, not subject to the vote of the legislature, although there is nothing in the Constitution to prevent a discussion on it); and (b) the sums required to meet other expenditure to be voted by the legislature. The estimates are also split up into two divisions to distinguish disbursements on Revenue Account from those on Capital Account. The latter covers disbursements on capital outlay, advances granted by the government, discharge of permanent debt and other items of similar nature. The estimates of expenditure are also split up into demands for grants. These demands are arranged Ministry-wise and generally cover the requirements of each administrative service.

The revenue estimates are prepared in the Ministry of Finance on the basis of existing level of taxation at that time and the trend of collections. The effects of taxation proposals, if any, are also indicated separately in the budget.

The Indian budget year commences on 1st April and consequently, the budget grants for the budget year are available for expenditure from 1st April to 31st March next year. The various stages leading up to the preparation and compilation of the budget are :

(1) preparation and consolidation of the estimates by the Heads of Ministries/Departments;

(2) scrutiny of the estimates by the departmental controlling officers;

(3) scrutiny by the Ministry of Finance;

(4) consolidation of the estimates by the Ministry of Finance; and

(5) consideration of the consolidated estimates by the executive government and a further review in the light of any comments.

In about September or October every year, i.e., 5-6 months before the commencement of the fiscal year, the administrative units or the operating agencies are required to make an estimate of the expenditure required during the next fiscal year. The general rule is that he who spends the money must also prepare estimates in advance. The items of income and expenditure contained in these statements show : (a) actual figures of the previous three years;[23] (b) the sanctioned budget estimates for the current year; (c) revised estimates for the current year;[24] (d) proposed estimates for the next financial year, with reasons for any increase or decrease estimated; and (e) actuals of the current year available at the time of preparation of the estimates and actuals for the corresponding period of the previous year. "The task of framing the budget estimates is one requiring sound judgement and experience. It is not a simple arithmetical exercise in striking out averages of previous years' actuals and putting in a safe figure which would not look exactly like a repetition of the last year's performance. The circumstances of no one year are exactly similar to those of the previous year and yet they are not quite dissimilar. One has, therefore, to use his judgement in estimating the similarities and dissimilarities and making due allowance for each."[25]

The estimates proposed by the Ministries/Departments then go to the respective Departmental Controlling Officers who : (a) scrutinize them fully; (b) revise the estimates where necessary giving reasons therefor; and (c) give the approval. The consolidated estimates are then transmitted to the Ministry of Finance with a copy to the Accountant General Central Revenues (AGCR). The latter examines the various items and ensures that all the sanctioned charges are included in the estimates and that unsanctioned charges have not been included therein. In case any change is suggested by the AGCR, the concerned administrative Ministry/ Department will also be consulted before it is accepted. Certain estimates are prepared by the AGCR for the reason that his office is in the best position to know the actuals and probables. He then submits his comments to the Ministry of Finance together with these estimates by about December. They are accepted without question, since the government has already assumed liability for these charges.

[23]The actuals of the past three years are the basis on which the structure of estimating rests primarily, adjusted by the expected changes brought about by the changing economic situation.

[24]The revised estimate is an estimate of the probable revenue and expenditure of the current financial year framed on the basis of the actual transactions so far recorded and the anticipations for the rest of the year.

[25]Wattal, P.K., *op.cit.*, p. 62.

Preparation of the Defence Budget

While preparing the estimates for defence, such estimates are split up into primary units of appropriation. The overall control of the defence finance vests in the Finance Wing of the Ministry of Defence, which is divided into several branches, each under a principal staff officer. These branches prepare the estimates which are submitted to the Ministry of Defence where they are scrutinised in a meeting where the services are invited and at which the representatives of the Finance Division of the Ministry of Defence are also present. Then the estimates are submitted and finally reach the Financial Adviser and the Secretary and if any further policy decisions are to be taken, it is done at this level. The budget then goes to the Defence Committee of the Cabinet for approval. After such approval the estimates are sent to the Ministry of Finance for incorporation in their estimates.

Preparation of the Railway Budget

Indian Railways are a Departmental Commercial Undertaking of the Government of India and as such a different method is followed in preparation of the Railway budget. The framing of the budget has to be preceded by a careful forecast of the expected traffic, both passenger and goods, to be handled by the Railways during the budget year. Such a forecast must be based upon a clear view of the functioning of the economy in the budget year.

On the expenditure side, there are five broad divisions. *Firstly*, it is Administration, which includes the cost, mainly for the staff of administrative offices and of general departments, like accounts, stores, etc. *Secondly*, comes the Repairs and Maintenance, perhaps the largest. *Thirdly*, it is the operating Expenses, which include the cost of the operating staff, fuel, consumable stores, etc. The *fourth* division consists of items such as retirement benefits, medical aid, health services, contributions to the staff benefit fund, etc. In the *fifth* are included the cost of certain minor works charged to revenue. The budget of each zone of the Indian Railways is prepared separately by the spending Departments and subjected to close and expert scrutiny by the built-in financial organisation in each Railway Administration. Such estimates are then submitted to the Railway Board for final consolidation into the Railway budget.

Consolidation by the Ministry of Finance

Budget estimates prepared by the administrative Ministries/Departments, after they have been verified by the AGCR, are scrutinised by the Ministry of Finance. The scrutiny exercised by the Ministry of Finance is different in character from that applied by the Controlling Officers.

The policy behind the prepared expenditure, its necessity or general propriety, etc., are the concern mainly of the administrative unit. The Ministry of Finance is concerned, primarily with the economy and is to keep the demands within the revenues available for a particular period. Such scrutiny, therefore, is:

(1) The least in respect of items of expenditure that are charged upon the Consolidated Fund of India.

(2) Is nominal and purely administrative in the case of 'standing charges' which relate merely to permanent charges like salaries and allowances of permanent establishments and fixed contingent charges.

(3) Is more exacting according to the importance, need and the urgency of the expenditure, in respect of 'new items' of expenditure which are either proposed for the first time or are being continued from year to year, but nevertheless are not standing charges. Besides, 'new items' cannot be included in the estimates forwarded by the administrative Ministries/Departments without the prior sanction of the Ministry of Finance. Such items are separately and distinctly shown in the estimates.

Budgeting for the new schemes poses a different proposition. The new scheme has to be formulated in the administrative units or operating agency in all its details. The same has to be approved by the Ministry-in-charge. The items of expenditure are then examined by the Financial Adviser accredited to various administrative Ministries/Departments. Estimates of capital expenditure are examined by the Financial Adviser of the Ministry, and further considered and screened by the Ministry of Finance in consultation with the Planning Commission. Finance examines it to find out whether details have been worked out or something is still left undone, and whether the rules of common prudence have been observed. If these points are found to be in order, the scheme is declared acceptable. It has then to compete for the available funds alongwith other new schemes of all the other Ministries/Departments. If the scheme succeeds in this competition also, budget provision is made, that is to say, the necessary expenditure is included in the budget to be presented before the legislature.

Quite frequently it happens that at the time the budget estimates are prepared, the Ministry/Department may not be ready with details of the scheme, especially the schemes broadly included in the successive Five Year Plans, but think that the scheme is essential to be included in the ensuing year's budget. Under such circumstances the Ministry/Department concerned can ask for a lump provision in the budget, subject to details being worked out before execution.

The decision of the Ministry of Finance is final in the matter of determining the provision. Differences over the quantum of provision or the need for including an item of expenditure are resolved by discussion at Ministerial level. If they still persist, the matter is taken to the Cabinet. In case a settlement cannot be reached, then the arbitration is had either from the Prime Minister or the Cabinet.

The budget estimates of the Parliament are submitted to the Ministry of Finance. The estimates are not criticised nor are comments made thereon by the latter.

After all these preliminaries are over the Budget Division of the Ministry of Finance consolidates the estimates received from various Ministries/Departments and prepares a consolidated statement of the estimated disbursements necessary during the next year on the existing basis that is to say without any new scheme being included.

Estimates of Revenue

Estimation of revenue is also an important aspect of the procedure of budgeting. This is arrived at by the Ministry of Finance in consultation with the Central Board of Direct Taxes and the Central Board of Indirect Taxes, and with the assistance of the Income Tax, and Central Excise and Customs Departments, the most important revenue collecting agencies. A forecast is made of the expected revenue for the coming financial year at the existing rates of taxation. In order to match the revenues with the magnitude of the expenditure, the Finance Ministry proposes alternations in the rates of existing taxation. The rates of taxes may be increased, or decreased, or new taxes may be levied, or old ones may be abolished.

Next, all the new schemes that have been approved in consultation with the Finance in course of the year and which are now forwarded to the Finance with a request for provision of funds, are also compiled by the latter at this stage and the total expenditure involved, if all the new schemes were to be accepted for execution during the next financial year, is arrived at. The Ministries/Departments are requested to indicate the priorities of their different schemes so that if any one has got to be excluded, it can be done on the basis of the said order or priority. Side by side with this are shown actual figures of the previous five years, the budget estimates approved at the commencement of the current year and the revised estimates for the current year (i.e., the budget figures revised on the basis of actuals of the past nine months and estimates for the remaining three months). In addition to this the Finance prepares an estimate of receipts from possible new sources of taxation and from possible increases in the existing rates. Possible proceeds of borrowings during the ensuing financial year are also estimated.

The consolidated figures are now considered by the Cabinet who issue their orders thereon.

The Budget Division of the Ministry of Finance then makes the necessary changes in the estimates in accordance with the orders of the Cabinet, brings the revised estimates for the current year up-to-date and prepares two important documents : (a) 'Annual Financial Statement', and (b) 'Demands for Grants'. These documents are then submitted to the legislature for consideration and approval.

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6

The Budget in the Legislature

In all the parliamentary democracies, the budget, after having been prepared and passed by the executive government, is presented to the legislature, where it is discussed and finally voted. The responsibility of presenting the budget to the legislature is that of the executive government. Someone representing the executive government, usually the Finance Minister, must present the budget to the legislature. "Centralized executive responsibility for budget preparation and submission will facilitate budget authorization by the legislature and enable it to centre attention on programme review and policy considerations."[1] The exclusive right to present the budget to the legislature gives an opportunity to the executive government to formulate economic and financial policies of the country and to keep a watch over the due execution of such policies. The review by the legislature of the budget prepared and presented by the executive government provides a major opportunity, rather the most important occasion, for the examination of the character and quality of administrative actions. Such an examination is inherent in a parliamentary democracy and every legislature has a watch-dog responsibility.

The budget then goes through the following stages before it is passed finally by the Parliament :

(1) presentation to the legislature;

(2) general discussion;

[1]Burkhead, Jesse, *Government Budgeting*. New York : John Wiley and Sons, 1956, p. 306.

(3) discussion and voting of Demands for Grants;
(4) consideration and passing of Appropriation Bill; and
(5) consideration and passing of the Finance Bill.

2

Presentation

In India, the 'budget' requires to be recommended by the President before it is presented to the legislature as, under the Indian Constitution, the President's recommendation is required for the imposition, abolition, remission, alteration or regulation of a tax; for the regulation of the borrowing money; and for withdrawal of moneys from the Consolidated Fund of India. Article 112 of the Constitution reads as follows :

"(1) The President shall in respect of every financial year cause to be laid before both the Houses of Parliament a statement of the estimated receipts and expenditure of the Government of India for that year, in this part referred to as the 'annual financial statement'.

(2) The estimates of expenditure embodied in the annual financial statement shall show separately :

(a) the sums required to meet expenditure described by this Constitution as expenditure charged upon the Consolidated Fund of India; and

(b) the sums required to meet other expenditure proposed to be made from the Consolidated Fund of India, and shall distinguish expenditure on revenue account from other expenditure."

Rule 213 of the Rules of Procedure and Conduct of Business in Lok Sabha[2] provides that the budget may be presented in two or more parts and when such presentation takes place, each part will be dealt with in the same manner as if it were the budget. This rule regularises the procedure for dealing with the Railway budget, for which there is no specific provision in the Constitution, but which is presented separately from the general budget.

The interval between the presentation of the budget and the commencement of the financial year has been about five weeks in India, and it has been a long standing convention to present the budget on the

[2]Hereafter, unless otherwise specified, the *Rules of Procedure and Conduct of Business in Lok Sabha*, Fifth Edition. New Delhi : Lok Sabha Secretariate, 1957, shall be referred to simply as Rule(s).

last working day of February. "If on the last working day of February the House is not scheduled to meet, the House is summoned to meet specifically at 5.00 p.m. on that day for presentation of the Budget."[3] After recommendation by the President required as described above, the budget is first presented in the Lower House (Lok Sabha) by the Minister of Finance.[4] He makes a speech introducing the Budget which contains:

(a) A survey of general economic conditions prevailing in the country during the year about to close. Such a survey usually includes a review of the foreign exchange situation and the resultant development in the monetary policy of the country. The budget has also become an instrument of economic, political and social policy in so far as that may be shaped by financial measures. The broad directions towards such economic, political and social goals and the extent of progress towards them also become evident from the budget speech.

(b) An explanation of any variation between the budget estimates approved at the commencement of the year about to close and the revised estimates (based on the actuals of the first ten months and the estimated figures for the remaining two months).

(c) Explanatory comments on the budget estimates for the coming year and the proposals for meeting the deficit (by fresh or increased taxation or otherwise) or for disposing of the surplus as the case may be.

The presentation of the budget in the Parliament is an important occasion and apportunity is often taken to make announcements of policy having a bearing on the economic and financial position of the country.

The budget speech and the statements accompanying it though containing a great deal of information are not sufficiently detailed to allow a proper examination and criticism of the proposals by the members of the legislature. They are, therefore, supplied also with books containing the necessary detailed figures. On the conclusion of the speech, another Minister, usually a junior in the Ministry of Finance, presents the budget documents together with a copy of the Finance Minister's speech, to the Upper House (Rajya Sabha). The presentation of the budget is thus done simultaneosly in both the Houses.

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[3]Kaul, M.N., and Shakdher, S.L., *Practice and Procedure of Parliament*. Delhi: Metropolitan Book Co., 1968, p. 546, *Footnote*.

[4]It is not provided by the Constitution as to who will present the Statement in the two Houses respectively. Under the Rules 206-207 the Finance Minister personally presents the General Budget to the Lower House.

The following documents are presented to the legislature alongwith the 'annual financial statement' :

(1) An Explanatory Memorandum on the Budget briefly explaining the nature of receipts and expenditure during the current year and the next year and the reasons for the variations of the estimates in the two years.

(2) A Summary of Demands for Grants.

(3) The Book of Demands showing the provisions Ministry-wise under a separate demand for each department or service of the Ministry. The Finance Ministry may, however, include in one demand grants proposed for two or more Ministries/Departments or make a demand in respect of expenditure which cannot readily be classified under particular Ministries. Each demand contains first a statement of the total grant proposed and then a statement of the detailed estimate under each grant divided into items.

(4) Demands for Grants—Posts and Telegraphs Department.

(5) Defence Services Estimates.

(6) An Appropriation Bill.

(7) A Finance Bill detailing the taxation measures proposed by the government.

(8) Memorandum explaining in detail the various provisions of the Bill and the effect of the measures proposed on the finances of the country. As a general rule, it is usual for government to announce their taxation proposals and/or changes in the tariff rates with the budget or during the discussion of the budget by the legislature. Changes in direct taxes such as tariff rates can also be announced at different times of the year as and when they become necessary, and in fact they are so made.

(9) The Economic Survey.[5]

(10) Economic Classification of the Budget.

(11) Annual Reports of the various Ministries—presented with the Demand for Grants of each Ministry.

As for the Ministry of Railways, a separate Railway budget is presented by the Railway Minister in the first or second week of February. It contains the Demand for Grants for Railways, and the Railway Minister, in his speech, introduces the Budget and Explanatory Memorandum of the Railway Budget.

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[5]The Economic Survey is now presented to the Parliament earlier than the presentation of the budget.

3

General Discussion on the Budget

There is no discussion on the budget on the date it is presented to the Parliament.[6] On a day appointed by the Speaker a general discussion on the Budget as a whole takes place. "According to the practice obtaining in the Lok Sabha, the General Budget is ordinarily discussed after about a week or ten days of its presentation to the House, while the Railway Budget is taken up for discussion after about a week of its presentation".[7] The budget as a whole or questions of fiscal policy relating thereto are covered in this discussion and it helps the government to find out the general attitude of members to the Budget proposals. The Speaker's direction[8] regarding budget discussion is, "that during the general discussion on the budget, the House will be at liberty to discuss the budget as a whole or any question of principle involved therein. The scope of discussion at this stage is thus confined to the general examination of the budget, i.e., the proper distribution of the items of expenditure according to the importance of a particular subject or service, the policy of taxation as it is expressed in the budget and in the speech of the Honourable Finance Minister."

"Members may, therefore, make observations in regard to the general scheme and the structure of the budget. The general scheme of the budget will include consideration of revenue, surplus or deficit, revenue and expenditure account and the overall surplus or deficits. So far as the revenue account is concerned, members may take into account the method of estimation, whether the revenue is over-estimated or underestimated, whether the expenditure is pitched too high, etc."

"As regards general grievances, they may be referred for ventilation at the time of considering the Finance Bill. That will also be the proper occasion for going into details of taxation and matters related thereto. Similarly details of expenditure may be discussed when demands for grants come up before the House."

Article 113 (1) of the Constitution allows discussion of expenditure charged upon the Consolidated Fund of India. The Article provides: "So much of the estimates as relate to expenditure charged upon the Consolidated Fund of India shall not be submitted to the vote of Parliament, but nothing in this clause shall be construed as preventing the

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[6]Rule 205.

[7]Kaul, M.N., and Shakdher, S.L., *op.cit.*, p. 550.

[8]Lok Sabha Debates, Third Series, Vol. II—No. 16, c. 2879-80.

discussion in either House of Parliament on any of those estimates." The provision assures that no item is exempted from discussion in the legislature. Hence, though the Article prohibits submission of such expenditure to the vote of the House and consequently the House cannot refuse or reduce the items of such expenditures, either House gets an opportunity, each year, to criticise the conduct or administration of the services which are so charged. Members are also free to ask for any information relating to these items. No motion, however, can be moved at this stage and the budget too is not submitted to the vote of the House.

4

Voting of Demands for Grants

After the general discussion of the budget is over, the various demands, i.e., demands for grants are brought up for sanction one by one. A separate demand for grant is ordinarily made for each Ministry/Department, but the Finance Minister may include in one demand, grants proposed for two or more Ministries/Departments or put up a conjoined demand in respect of expenditure which may not be capable of being classified under particular Ministries/Departments. Each demand contains first a statement of the total grant proposed and then a statement of the detailed estimate under each grant divided into items.[9]

Separate dates are alloted for each Ministry and the demands relating to that Ministry are discussed at that time. The discussion and voting on demands for grants usually occupy about three weeks. Usually, the rules provide that no more than two days shall be taken up for the debate on any particular grant. On the last day of the allotted days, all demands which have not been taken up by the House and have, therefore, not been passed are guillotined, i.e., put to the vote without any dabate. The demand is made in a motion : "that a sum not exceeding Rs.......be granted to the President to defray the charges which will come for payment during the financial year ending 31st March, 19......in respect of...... (The subject of demand)." If the rules provide that one demand shall not be debated for more than two days, and a demand is not finished on the day it is moved, the demand is also guillotined on the second day. A demand when voted becomes a grant.[10]

At the time of presenting the demands, an annual report of the concerned Ministry, and the demands which are being considered, are

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[9]Rlue 206.

[10]The distinction between a 'demand' and a 'grant' is the same as between a 'bill' and an 'act'. Once a demand for grant has been voted it becomes a grant.

presented to the House. The annual reports of the Ministries contain accounts of the working of the Ministry concerned during the year ending, their important achievements, their proposals and programmes for the coming year and probably a justification in broad terms, for the additional moneys asked for in the demand for grants. "The reports are valuable and are in fact a substitute for the speech which the Minister would have been required to make while moving his demand and to justify it."[11] The annual reports of the Ministries/Departments, which commenced being submitted to the House in 1951, also form the subject of discussion while the demand for grant is discussed. A similar procedure is followed in respect of Railway budget also which is submitted to Parliament separately. There is only a general discussion on the budget in the Upper House. It does not vote the demands for grants. The estimates of revenue receipts are included in the budget which are discussed as a whole. They are not discussed separately like the demands for grants.

Any member may make suggestions during the discussion of the budget for enhancement of duties and the imposition of new taxes. The taxation proposals of the executive government are given effect through the introduction of the Finance Bill and during the consideration of that Bill, the members may discuss the monetary and financial policies of the executive government. Members may table amendments to the Bill seeking to vary the rates of taxes included in the Bill. Amendments which seek to increase the limits of a tax proposed in the Bill require the recommendations of the President before they can be moved.

It may be repeated that no demand for a grant can be made except on the recommendation of the President. This means that demands for grants can emanate only from the executive government and not from private members. Further, the legislature can reduce a grant demanded or refuse it altogether, but cannot increase it. Should the legislature be of the opinion that expenditure on a particular item ought to be increased, it can only make a recommendation to that effect which may or may not be accepted by the executive government. This is the recognised constitutional practice in the British House of Commons also. There is thus a double check over the expenditure—by the executive government and by the legislature. No expenditure from the Consolidated Fund of India can ordinarily be incurred unless both the legislature (Lower House) and the executive government are in agreement.

Cut Motions or Amendments to Motions for Grants

The legislature has the power of reducing grants. Such a motion may be moved by a member for the reduction of the votable expenditure

[11]Kaul, M.N., and Shakdher, S.L., *op.cit.*, p. 560.

of the demands for grants, submitted to the vote of the House. Such a motion is called a 'cut motion'. Cut motions may be for : (a) reduction in expenditure if the mover feels that the expenditure proposed under any head is excessive; *or* (b) disapproval of some point of principle or policy; *or* (c) effecting economy; *or* (d) in order to ventilate a specific grievance under a demand for grant.

The Indian legislatures have, by their rules of procedure, defined three kinds of amendments known as cut motions.[12] These are 'Policy Cuts' or 'Policy Cut Motions', 'Economy Cuts' or 'Economy Cut Motions', and 'Token Cuts' or 'Token Cut Motions'. Any cut motion moved by a member must conform to either of these three types.

Disapproval of a Policy Cut

When the object of a cut motion is to disapprove of the policy underlying a demand, the demand is sought to be reduced to a nominal amount. This is known as a 'disapproval of policy cut'. Such a motion is "that the amount of the demand be reduced to Re. 1".[13] Such a cut motion, if carried by a majority of the House, amounts to a vote of censure on the government. Any member giving a notice of such a cut motion is ordinarily required to indicate in very precise terms the particulars of the policy which he proposes to discuss. The discussion thereafter is confined to the specific point(s) mentioned in the notice and it is open to the member to advocate an alternative policy.

The Economy Cut

Whenever it is contended that economy in the expenditure proposed can be effected, the motion moved is known as the 'economy cut'. The economy cuts are directed, therefore, to reduce the demand by such amounts as the members want to effect an economy. The amounts of reduction vary accordingly. Whenever an 'economy cut' is moved, the motion is "that the amount of the demand be reduced by Rs......(a specified amount).[14] The amount put up for reduction is *either* a lump-sum reduction in the demand *or* omission *or* reduction of an item in the demand. The notice of such a cut motion is to indicate, in a brief and precise manner, the particular matter on which discussion is sought to be

[12] Rule 209.

[13] The actual form in which the disapproval of policy cut motion is moved is "That the demand under the head (here title) (pages...) be reduced to Re. 1 (Disapproval of policy regarding...) (here brief subject matter of the title)".

[14] The actual form in which the economy cut motion is moved is : "That the amount under the head...(page...) be reduced by Rs. 1 crore (Failure to control and eliminate wasteful expenditure in...)".

raised and the discussion is confined to the points as to how the economy can be effected.

Token Cut

In order to ventilate a specific grievance within the sphere of the responsibility of the Government of India, a 'token cut' is moved by the members. By means of 'token cuts' the amount of the grant is sought to be reduced by a fixed sum, generally Rs. 100, to raise a discussion on some grievance. Token cuts are moved in the manner : "That the demand under.... .(the head) be reduced by Rs. 100". The object of a 'token cut' is to bring pointed attention to a specific grievance which is required to be stated specifically so as to enable the government to answer. Discussion on such a cut motion is confined to the particular grievance specified in the motion.

Cut motions are ordinarily moved only by the members of the opposition, but there is no rule or parliamentary practice (except issuance of a party whip) which prevents a supporter of the government from giving notice of, and moving such motions.

Each cut motion specifies the point(s) in precise terms which a member wants to discuss. For example, when the discussion is on a 'policy cut', a member can advocate for the adoption of an alternate policy. For an 'economy cut', the discussion is confined as to how economy can be effected. As regards 'token cut' the discussion is limited to the particular grievances specified in the motion. Generally, the number of cut motions is the heaviest under the category of 'token cuts'. Usually, a number of such amendments are tabled specifying the subject matter on which discussion is sought to be raised. A practice prevails in the Indian legislature[15] of putting together all such amendments, or 'cut motions' as they are called, involving the same amount, to the vote.

Conditions of Admissibility of Cut Motions

In order that a notice of motion for reduction of the amount of demand may be admissible, it must satisfy the following conditions:[16]

(1) it should relate to one demand only;

(2) it should be clearly expressed and should not contain arguments, inferences, ironical expressions, imputations, epithets or defamatory statements;

(3) it should be confined to one specific matter which shall be stated in precise terms;

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[15]Lok Sabha Debates, Part ii, 1 March, 1956, c. 776.

[16]Rule 210.

(4) it should not reflect on the character or conduct of any person whose conduct can only be challenged on a substantive motion;
(5) it should not make suggestions for the amendment or repeal of existing laws;
(6) it should not refer to a matter which is not primarily the concern of the Government of India;
(7) it should not relate to expenditure charged on the Consolidated Fund of India;
(8) it should not relate to a matter which is under adjudication by a court of law having jurisdiction in any part of India;
(9) it should not raise a question of privilege;
(10) it should not revive discussion on a matter which has been discussed in the same session and on which a decision has been taken;
(11) it should not anticipate a matter which has been previously appointed for consideration in the same session;
(12) it should not ordinarily seek to raise a discussion on a matter pending before any statutory tribunal or statutory authority performing any judicial or quasi-judicial functions or any commission or court of enquiry appointed to enquire into, or investigate, any matter;[17] and
(13) it should not relate to a trifling matter.

5

Consideration and Passing of the Appropriation Bill

No money can be withdrawn from the Consolidated Fund of India except under appropriation made by law.[18] Voting of the expenditure estimates and demands for grants or supplies by Parliament does not by itself confer upon the government sufficient authority to incur expenditure to the extent voted. In order to regularise it, an Appropriation Bill is introduced, which is discussed by the legislature and passed. An Appropriation Bill, therefore, is in the nature of a formal legislation, to give effect to grants already voted by the legislature and expenditure charged on the Consolidated Fund of India by the Constitution.

[17]Provided that the Speaker may in his discretion allow such matter being raised in the House as is concerned with the procedure or stage of enquiry, if the Speaker is satisfied that it is not likely to prejudice the consideration of such matter by the statutory tribunal, statutory authority, commission or court of enquiry.

[18] Article 114.

The scope of the debate on the Appropriation Bill is restricted to matters of public importance or administrative policy implied in the grants covered by the Bill and which have not already been raised while the relevant demands for grants were under discussion. "The debate on an Appropriation Bill shall be restricted to matters of public importance of administrative policy implied in the grants that have not already been raised while the relevant demands for grants were under consideration."[19] The various points that have been discussed at length during the course of the debates relating to the various demands for grants cannot be the subject matter of discussion on Appropriation Bill.[20] Subjects on which cut motions were moved and negatived during the discussion on demands for grants are not permitted to be discussed again during the discussion on Appropriation Bill.[21] Whatever is not relevant to the discussion on demands for grants is also not relevant to the debate on the Appropriation Bill.[22] Matters of detail are not gone into during the discussion on an Appropriation Bill.[23] "The Speaker may, in order to avoid repetition of debate, require members desiring to take part in discussion on an Appropriation Bill to give advance intimation of the specific points they intend to raise, and he may withhold permission for raising such of the points as in his opinion appear to be repititions of the matters discussed on a demand for grant or as may not be of sufficient public importance."[24] "When a member raises certain points, with the permission of the Speaker, on the motion for consideration of an Appropriation Bill, the Minister concerned must be present in the House to answer those points."[25]

Article 114(2) of the Constitution prohibits the moving of any amendment to an Appropriation Bill "which has the effect of varying the amount or altering the destination of any grant so made or of varying the amount of any expenditure charged on the Consolidated Fund of India, and the decision of the person presiding as to whether such an amendment is inadmissible under this clause is final." It is obvious that the grants already voted by the House should not be disturbed. At this stage though the debate is purely formal, it is yet important as a further opportunity which it gives to the members of making suggestions and comments on the activities of the government in respect of the various

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[19]Rule 218(4).

[20]House of People Debates (II), April 7, 1953, cc. 3879-80; and April 8, 1953, cc. 3921-22.

[21]*Ibid.*, April 8, 1953, c. 3923.

[22]*Ibid.*, December 12, 1952, c. 2205.

[23]Lok Sabha Debates, May 29, 1957, cc.2664-67.

[24]Rule 218(5).

[25]Kaul, M.N., and Shakdher, S.L., *op.cit.*, pp. 566-67.

heads under which moneys are being authorised to be drawn from the Consolidated Fund. Under the Constitution an Appropriation Bill is also necessary for the Vote of Account which is considered and passed by the Parliament before the commencement of the financial year. The Appropriation Bill introduced at the end of the voting of the demands for grants applies to the remaining sums only.

The Appropriation Bill as passed by the Lower House is discussed and passed by the Upper House. No modification is made by the latter. Until the Appropriation Bill as passed by the two Houses has been assented by the President and becomes law, no money can be withdrawn from the Consolidated Fund.

6

Consideration and Passing of the Finance Bill

'Finance Bill' means the Bill ordinarily introduced in each year to give effect to the financial proposals of the Government of India for the next following financial year and includes a Bill to give effect to supplementary financial proposals for any period.[26] It does not contain, however, provisions intended to make permanent changes in the existing laws unless they are consequential upon or incidental to the taxation proposals.[27] After the moneys have been voted by the House, it will have to consider the ways and means of raising the revenue to meet that expenditure. That is, the House has to consider the second aspect of the budget, i.e., income side. This is achieved by passing the Finance Bill.

A Finance Bill deals with imposition, remission or regulation of taxes and it has to be dealt with and passed by the Parliament before the proposals therein could be enforced. In India it is usual to present these proposals alongwith the budget. The Bill, embodying proposals for : (a) new taxes to be imposed for the first time; (b) taxes which are to be increased; and (c) taxes requiring renewal or revision annually, is discussed and the requisite law is enacted, as in the case of any other Bill, to enable the executive government to bring them into force.

Sufficient latitude of discussion is allowed during the debate on the Finance Bill. A criticism of the entire financial policy of the government as well as the general administration is in order on the principle of 'no

[26]Rule 219(1).
[27]Lok Sabha Debates (II), December 7, 1956, cc. 2080-2105.

taxation without representation'. The reason for this wide latitude in case of the Finance Bill in contrast to the practice relating to an Appropriation Bill is that in the case of latter, there are two earlier opportunities for debate, namely, at the stage of the general discussion and again at the stage of granting the demands, so that as a matter of convention, the House passes the Appropriation Bill without much further discussion. The Finance Bill, however, is discussed for the first time and the members must have an opportunity to discuss the taxation proposals fully.

More specifically : (1) a member can discuss any action of the Government of India; (2) actions of the State governments are not to be the subject of criticism in the discussion of the Finance Bill; (3) general criticism of the policy of the government is permissible; (4) discussion in detail of particular estimates is not in order but a member can discuss matters of public policy that contributed to a deficit; (5) general principles underlying the budget can be discussed, but not the details of those principles; (6) in short the whole administration comes under review but questions which have already been discussed in a previous debate cannot be reopened; and (7) discussion on a clause of the Finance Bill and its amendments has to be confined to the taxation proposed and to possible alternatives.[28]

In view of the declaration under the Provisional Collection of Taxes Act, 1931, the Finance Bill has to be passed by the Parliament and assented to by the President before the expiry of seventy-fifth day after the day on which it was introduced.

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[28]Kaul, M.N., and Shakdher, S.L., *op.cit.*, p. 569.

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7

The Execution of the Budget

The execution of the budget is the responsibility of the executive government, and, therefore, the distribution of powers within the executive government determines the procedure for the execution of the budget. It is an axiom of financial control that for every grant there must be an authority responsible for its administration and particularly to see that the amounts are spent on the subjects as sanctioned, moneys are utilised in the most economical manner and the expenditure is kept within the funds allotted for the purpose. An efficient execution of the budget presupposes, therefore, strong central direction and control. "If this is not done the budget will fail in a large measure to accomplish its purpose, which is to produce stability in government's finance by making both ends meet."[1] In order to make the execution of the budget an ideal one, the system must aim at the following objectives : (a) preservation of the intent of the legislature; (b) observance of financial limitations; and (c) the maintenance of flexibility.

As regards the preservation of the intent of the legislature, it must be kept in mind that the budget to be executed is the budget sanctioned by the legislature. The expenditures to be incurred and the revenues to to be raised must be put into practice in the spirit and intent the legislature had while sanctioning such authorizations. It is only in this way that the sovereignty of the electorate and authority of the legislature can duly be safeguarded.

[1]Buck, A.E., *Public Budgeting*. New York : Harper and Bros., 1929, p. 452,

So far as the observance of financial limitations is concerned, the use of the resources must be with utmost economy and efficiency, and the financial sanctions expressed by the legislature must be adhered to. A proper execution of the budget, as a matter of fact, means execution of financial control in the sense that not only the expenditures are to be kept within the authorized limits, but also to make the funds available for such disbursements in time. There must, therefore, be an efficient planning of the ways and means position on the part of the executive government.

Coming to the maintenance of flexibility, it must be borne in mind that during the course of the financial year, changes in economic conditions from those assumed at the time of preparation of the budget may come about leading to cost fluctuations in the programmes. The execution of the budget must, therefore, be able to cope with such unexpected eventualities.

2

Execution of the Budget in India

Execution of the Budget on the Expenditure Side

In India, the Ministry of Finance of the Government of India exercises an overall control over the execution of the budget. The control of the Ministry of Finance, being the government's instrument for carrying out its financial policies and for exercising supervision on the finances of the administrative authorities, keeps its check over public expenditure at three stages : (a) approval of programmes or policies in principle; (b) acceptance of provision in the budget estimates; and (c) prior concurrence to incurring of expenditure subject to such powers as may have been delegated to the administrative Ministries/Departments. "It is the control at the first and third stages that generally engages much of the time of the Finance Ministry and that impinges on the day-to-day working of the administrative Ministries. A control at these stages, if too rigid or detailed involving much time and effort, can slow down the pace of work, delay the implementation of projects—particularly developmental, commercial or industrial ones—and thereby cause loss of national effort or income. While the need for control or scrutiny is not denied, it must be constructive, purposeful, imaginative, and not narrow in outlook or cramping in effect."[2]

[2]Administrative Reforms Commission, *Report on Finance, Accounts and Audit.* New Delhi, January 1968, p. 24.

Once the budget has been approved by the legislature and the Appropriation Act and Finance Act come into being, the plan as contained in the budget comes into operation. The funds voted by the legislature for expenditure during a financial year are, as far as the legislature is concerned, moneys placed at the disposal of the executive government as a whole for expenditure on specific activities. The important task at that stage is to secure compliance with the budget. The machinery which the executive government has devised for discharging its responsibility is composed of: (1) a system of controlling officers; (2) a system of competent authorities who issue financial sanctions; (3) a system of drawing and disbursing officers; and (4) a system of payments and accounts.

Ordinarily, the head of the Ministry/Department acts as the controlling officer in respect of that part of the budget with which the Ministry/Department is concerned. After the budget is approved and the Appropriation Act comes into being, the Ministry of Finance advises each administrative Ministry/Department that part of the budget with which the latter are concerned. The funds are thus placed at the disposal of the controlling officers concerned, whose duties are to exercise a continuous vigilance over current and anticipated expenditure with a view to ensure that the amounts so placed at their disposal are spent on the specified purposes and are not exceeded without additional funds being obtained in time. The controlling officers then distribute and advise the moneys sanctioned to the various disbursing officers, restricting the expenditures of the latter to the amount the former advise them. It is incumbant upon the controlling officer to execute the part of the budget entrusted to him and to ensure that the execution is done according to the plan contained in the budget as approved by the legislature.

As regards payments, there are Treasuries and Sub-Treasuries all over the country. Drawing and disbursing officers prepare the bills for the amount(s) withdrawable, present them to the Treasury Officer(s), who, in turn, effect(s) the payment in cash/cheques drawn on the Reserve Bank of India/State Bank of India/Subsidiaries of the State Bank of India, provided the bills drawn are in order, according to sanctions, and provided there is budget allotment. At the end of each day the Treasury Officer compiles the accounts and such accounts alongwith the vouchers are sent to the Accountant General Central Revenue (AGCR) periodically.

At the time of the distribution of grants by the administrative Ministry/Department and the controlling officers, a copy of such a distribution is sent to the AGCR, who, in turn, advises the distribution to the Treasuries and at this point, the AGCR also has a method of controlling the progress of expenditure. There is thus a two-fold control over each item of expenditure, one from the administrative-end and the other from the payment-end. The AGCR keeps a watch upon the progress of expenditure vis-a-vis parliamentary sanction under each detailed head. In the administrative Ministry/Department, the controlling officers at their end, receive similar information from the disbursing officers under them, and thus are able to keep a track of the progress of expenditure. At different stages, the progress of expenditure is compared as between the administrative-end and the payment-end. An attempt is thus made to check each others' progress and to detect discrepancies at the earliest opportunity.

For the purposes of ways and means position, the Ministry of Finance receives a monthly report from the AGCR showing the receipts and disbursements by and from the Treasuries under heads of revenue and expenditure as well as under heads of debt and remittance. This enables the Ministry of Finance to keep a watch over the progress of actuals with the estimates and follow up the ways and means position.

In addition, there is a regular periodical review and appraisal of the progress regarding the execution of the budget. The first such review is known as the preliminary review and takes place in September, when four months' figures of actual expenditure are available. The second review takes place in December. The third review is undertaken in January when the revised estimates, based upon nine months' actuals, are prepared. Lastly, there is, modified appropriation for the final estimates. During such reviews, it is ascertained also whether or not it is necessary to approach the legislature with supplementary demands for grant of additional funds.

During the process of the execution of the budget, quite often, excesses and deficiencies take place under different heads within the same grant and transfers from surplus heads to deficient heads are sanctioned by the Ministry/Department concerned in consultation with the Ministry of Finance, where necessary. The Ministry/Departmental authorities are empowered, however, to effect transfer of funds from one minor head or sub-head to another. Ministry/Department not requiring the full amount of a particular grant surrender the surplus to the Ministry of Finance to be applied elsewhere.

The overall responsibility regarding the execution of the budget and an exercise of overall control of the budget performance rests with the Ministry of Finance. The responsibility of the Ministry of Finance, after the amounts are placed at the disposal of the administrative Ministries/Departments, "may be said to have two aspects : (1) on the part of the administrative ministry, there are still many matters which require frequent consultations with the Finance Ministry, and (2) on the part of the Finance Ministry, its relations arise out of its endeavours to ensure that the amounts are spent properly and that the achievement is in accordance with the plan included in the budget of the administrative Ministries. The matters that require consultation with the Finance Ministry may broadly be classified into two groups : (1) matters which are related to the budget, and (2) matters which arise out of the existing structure of financial powers."[3]

Execution of the Budget on the Revenue Side

Execution of the budget on the revenue side involves three considerations : (1) proper collection of revenues; (2) proper custody of the collected funds; and (3) proper distribution of funds.

The executive government proposes taxes, the legislature sanctions them, and then it is the responsibility of the former again to formulate a suitable implementation machinery and rules of procedure for the efficient and economic administration of the taxes. In India, the Department of Revenue in the Ministry of Finance is in overall control and supervision over the machinery charged with the collection of direct and indirect taxes. Such control is exercised through two Boards, namely, the Central Board of Direct Taxes and the Central Board of Excise and Customs. The Boards exercise supervision and control over the various administrative authorities who exercise powers conferred on them to implement different taxation laws.

The custody and disbursement of funds are done by Treasuries and Sub-Treasuries.

3

Some Aspects of Delegation of Financial Powers

Till recently, opinion was held that there was an excessive concentration of financial authority in the Ministry of Finance and there was no delegation of this authority even to the high-ranking and responsible officers in the other administrative Ministries/Departments. This type of tight financial control obviously results in dilatory and inefficient execution of the budget, especially so when, under the impact of planned economic development, the administrative Ministries/Departments are charged with the execution of large scale investment programmes in the public sector. "Sir Richard Tottenham in his report to the Government in 1945-46 emphasised that the need of the time was to develop a sense of financial responsibility in the spending departments and, for this purpose, to provide

[3]Premchand, A., *Control of Public Expenditure in India*. New Delhi : Allied Publishers, 1963, p. 58.

them with the assistance of their own financial advisers as distinct from the Finance Ministry's officials. He attached special importance to the strengthening of the financial set up within the spending departments. Shri Gopalaswamy Ayyangar, in his report on the Reorganisation of the Machinery of Government (1949) referred to the delays and deficiencies of the existing system of financial advice and observed 'that the system requires to be improved so as to increase the responsibilities of the individual ministries and remove the sense of frustration among them'."[4]

Shri Asok Chanda, a former Comptroller and Auditor General of India observed, "the present conception of control extends also to the examination of technical details, though the Finance Department is not properly equipped for this purpose. As a result, the objections raised are often elementary and uninformed in character. This not only acts as an irritant, but is also time-consuming. Ultimately these objections mostly come to be waived, but often only after interminable discussions, and control becomes effective only over establishment proposals, the expenditure on which forms but an insignificant fraction of the total cost. The Finance Ministry, therefore, whilst straining at the gnat has often to swallow the camel."[5] Shri A. D. Gorwala suggested, "what is really needed in financial matters is control and not interference in small matters leading to a great deal of waste of time and energy and frustration on the part of the administrative departments, that is the greater part of the government. This must be avoided."[6]

In this connection, the Estimates Committee, in its Ninth Report on 'Financial, Administrative, and Other Reforms' emphasised the need for coordination between the Ministry of Finance and the administrative Ministries/Departments and recommended delegation of more financial powers to the latter. The Committee observed that "concrete steps should be taken to achieve the end in view and to establish perfect cordiality between the administrative Ministries and the Ministry of Finance and to see that one is complementary to the other and helps in the ultimate objective." Following recommendations thus were made by the Committee:

(1) Before a scheme is embarked upon, it should be properly planned and it should also be ascertained whether the money required for it is available or can be made at the proper time.

[4]Administrative Reforms Commission, *Report on Finance, Accounts and Audit.* New Delhi, January 1968, p. 24.

[5]Asok Chanda, *Indian Administration.* London : George Allen and Unwin, 1960, pp. 222-23.

[6] *Ibid.*, p. 223. For more views on the problem expressed by eminent authorities, see, Administrative Reforms Commission, *Report of the Study Team on Financial Administration.* New Delhi, May 1967, pp. 56-58.

Detailed plans and estimates should be worked out fully so as to enable the Ministry of Finance to approve the scheme and accord financial concurrence.

(2) After the scheme is concurred in from the financial point of view by the Ministry of Finance, the detailed execution of the scheme and spending the money thereon should be the responsibility of administrative Ministry, which should also be given power to vary or to alter the amounts under the sub-heads of the scheme so long as the total outlay is not affected.

The general opinion developed, therefore, that the administrative efficiency and efficient execution of the budget demand that the administrative Ministries/Departments should possess sufficient financial powers once their demands for grants are sanctioned by the legislature. The Ministry of Finance could exercise, however, overall control only.

In view of the pressing need for better financial coordination between the Ministry of Finance and the administrative Ministries, the Government of India examined the details of the delegation of more financial powers to the administrative Ministries/Departments early in 1955. The Organization and Methods Division of the Cabinet Secretariat issued a brochure in 1957 entitled "Financial and Cognate Powers delegated to Ministries and Heads of Departments", in which the financial powers delegated as such were embodied. Proceeding further, the President made a reference in this regard in his address to the Parliament on February 9, 1959 in the following words : "My Government have recently made some important changes in regard to arrangement for budgeting and financial control over expenditure from the Civil estimates in order to secure a speedier implementation of our development plans, the administrative Ministries have been given wider financial powers to issue expenditure sanctions to schemes which have been included in the budget estimates after scrutiny by the Finance Ministry."

As regards the delegation of powers, the orders of the executive government of August 1958 were followed up by the promulgation, in December 1958, of the 'Delegation of Powers Rules, 1958'. These rules had, subject to some general limitations, conferred wide powers upon the administrative Ministries, Administrators and Heads of Departments. The salient features of the conferment of such powers are as follows :

(1) Full powers had been granted to the administrative Ministries/Departments for appropriations and reappropriations subject to expenditure being within the scope of the grant with certain provisions for prior consultation with the Ministry of Finance.

(2) Departments of the central government were empowered to sanction expenditure, subject to the existence of budgetary pro-

vision, on any scheme involving a total outlay of not exceeding Rs. 50 lakhs.

(3) Departments had been given powers, without any monetary ceilings, to sanction loans and grants-in-aid in accordance with rules prescribed in consultation with the Ministry of Finance and general control of the latter regarding rates of interest and period of repayment of loans.

(4) Departments had been empowered to enter into contracts or make purchases upto Rs. 25 lakhs.

(5) The powers of the Departments to create permanent and temporary posts and to incur conitngent and miscellaneous expenditure had been enhanced considerably.

(6) As the powers of writing off losses do not directly affect the principal object of quick implementation of development plans, such powers had not been enhanced to the same extent as other powers.

The scheme of delegation of additional powers to the administrative Ministries/Departments had been supplemented by posting, in each Ministry/Department, officers of appropriate status who are accredited to the Ministry of Finance, and who give necessary financial advice to the Ministry/Department. These officers were to be known as Financial Adviser, Additional Financial Adviser, Deputy Financial Adviser, and Assistant Financial Adviser and have the requisite ex-officio secretariat status in the Ministry/Department concerned.

These officers and their staff form the financial branch of the administrative Ministry/Department popularly known as 'Internal Finance'. They get associated with the formulation of all the schemes and projects, meant for eventual inclusion in the budget, from their inception. They are consulted on all financial matters arising out of enhanced financial powers now conferred upon the Ministries/Departments and also on matters involving a reference to the Ministry of Finance. Assistance is also extended to the administrative Ministry/Department in respect of control of expenditure in accordance with appropriation.

All the cases where the administrative Ministry/Department does not concur with the advice tendered by the Financial Adviser attached to it, have to be referred to the Secretary of the Ministry/Department concerned for orders, and, if the Secretary also differs from the advice, the case is to be brought to the notice of the Minister, who alone could overrule the Financial Adviser. A monthly statement of cases, if any, where the administrative Ministry/Department has not been able to accept the advice of the Financial Adviser, alongwith a summary of differences and the gist of final decision, is forwarded by the Secretary of the administrative Ministry/Department to the Secretary in the Ministry of Finance, Department of Expenditure, for information, and a copy of the same is forwarded to the Comptroller and Auditor General of India.

The twin aspects of control exercisable by the Ministry of Finance and the delegation of financial powers to the administrative Ministries continued to engage the attention of the Government of India. The question of decentralizing financial control was again mooted in the context of a speedy and effective implementation of the Third Five Year Plan. In 1961, a further scheme of delegation was worked out and included in a paper on "Measures for Strengthening of Administration" laid by the Prime Minister on the table of the Lok Sabha. It was stated that : "Responsibility for financial management should be devolved in greater measure than before both on the Ministries and executive agencies. The scheme now approved includes : (a) formulation of programmes for intensive pre-budget scrutiny between the Ministry of Finance and administrative Ministry necessitating the preparation of budget estimates earlier than usual; (b) further liberalization of financial powers to the Ministries in order to avoid references to Finance Ministry in the post-budget period except in vital matters; and (c) the exercise of control of important financial aspects by the Finance Ministry through adequate reporting system and test checks."

Under this scheme, introduced in September 1961, the delegation of powers affected in 1958 was further widened in important aspects, and was confined initially to four administrative Ministries, viz., Ministry of Commerce and Industry; Ministry of Community Development, Panchayat Raj and Cooperation; Ministry of Information and Broadcasting; and Department of Food in the Ministry of Food and Agriculture. This scheme envisaged the exercise of control by the Ministry of Finance mainly through pre-budget scrutiny and through rendom checks and work studies. The scheme was extended to other Ministries/Departments of the Government of India with effect from June 1, 1962.

The main features of the revised scheme are :[7]

(1) A proper scrutiny of the schemes, etc., submitted by the administrative Ministries for incorporation in the budget should be carried out by the Ministry of Finance before including such proposals in the budget. It has, therefore, been decided that budget proposals should be prepared by Ministries in greater detail and with as much precision as possible and referred to Finance Ministry a few months earlier than usual, say from the beginning of July each year.

[7]Administrative Reforms Commission, *Report of the Study Team on Financial Administration*. New Delhi, May 1967, pp. 60-61,

(2) Arrangements have been made with the Accountants General for the regular and timely supply of accounting data to the administrative Ministries to enable the latter to study the expenditures against the appropriations.

(3) Lump provision can be made for urgent schemes not yet ready in detail. But sanction against such provision can be issued only after the scheme had been accepted by the Ministry of Finance.

(4) This scheme of delegation of powers also provides that any amounts, without specified limits, may be sanctioned by the administrative Ministries if the projects for which such amounts are sanctioned have been earlier scrutinized and accepted by the Ministry of Finance. It may be noted that under the powers delegated in 1958, the administrative Ministries were authorized to sanction expenditure upto Rs. 50 lakhs only.

(5) The administrative Ministries have been delegated powers to incur expenditure on all items irrespective of the fact whether these are new items or otherwise, so long as such new items form part of an approved project.

(6) The administrative Ministries have also been delegated full powers for reappropriation between the primary units. To facilitate the exercise of these powers, it has been provided that the primary units consisting of allied schemes be formed into groups and such groupings be got approved by the Ministry of Finance.

(7) The administrative Ministries have been authorized to create posts upto a pay scale of Rs. 3000 p.m.

(8) Powers have also been delegated to the administrative Ministries to sanction excess expenditure over the original estimates upto the limit of 10 per cent or Rs. one crore, whichever is less, in cases where the administrative Ministry is satisfied about the special circumstances justifying the excess.

(9) It has been made an integral part of the scheme of 1962 that each Ministry should set up, internally, a competent work study unit which would assist the Ministry in laying down norms for particular types of work and would also examine such proposals for staff reorganization or creation of posts (both in the Department and in offices under it) as are referred to it.

In view of the emergency arising in the wake of Chinese aggression in October 1962, the scope of the delegation of financial powers introduced on June 1, 1962, was modified in certain important aspects, the most important of which were : (a) posts (other than those required for security and Plan purposes) could be created only with the concurrence of the Ministry of Home Affairs and the Ministry of Finance, and

(b) proposals for new construction could be sanctioned only with the concurrence of the Ministry of Finance, even though covered by the existing budgetary allotments.

The 1962 scheme was reviewed, however, towards the end of 1965 and revived in March 1966 with added emphasis on some aspects but without much alteration in its essential features. The effect of the orders of March 1966[8] was that the Ministries were given full authority to spend within their budget provision; they are to exercise this authority in consultation with the Internal Financial Advisers, but have no need to seek the sanction of the Finance Ministry. Further, the administrative Ministries have been given full powers to sanction expenditure on the various constituent schemes included in a project irrespective of the magnitude of the expenditure involved, provided that the project as a whole has been scrutinised and accepted by the Ministry of Finance. They have also been given powers to sanction, in their discretion, excess expenditure over the original estimates of the sanctioned schemes upto 10 per cent or Rs. one crore whichever is less, in cases where the administrative Ministry is satisfied about the special circumstances justifying the excess.[9]

The orders reaffirm in unequivocal terms the duties and responsibilities of the administrative Ministries : "Within the limits of the budget provisions and subject to observance of financial principles, standards and procedures prescribed under the various rules and standing orders, the administrative Ministries are free to incur expenditure in the exercise of the powers delegated to them and no reference to the Finance Ministry is necessary. The Secretaries of the administrative Ministries can also overrule the advice given by their Internal Financial Adviser (including officials of the Finance Ministry where they are consulted in respect of the delegated powers). The Secretaries thus have complete discretion in sanctioning expenditure within the delegated field. It also follows from this that each Secretary must assume full responsibility for decision taken in the exercise of delegated powers and for watching expenditure so that the budgetary provisions are in no case exceeded."[10]

It will be observed that, "the Secretary of the administrative Ministry is, under the latest scheme of delegation, fully competent to take a decision after obtaining the advice of the Financial Adviser in such cases as he may deem necessary. Moreover, the procedure for consulta-

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[8]Ministry of Finance, O. M. No. F. 10 (5) — E (Coord)/65 dated the 15th March, 1966.

[9]Administrative Reforms Commission, *Report of the Study Team on Financial Administration*, New Delhi, May 1967, pp. 51-52.

[10]Ministry of Finance, O.M. No. F. 10 (5) — E (Coord)/65 dated the 15th March, 1966.

toin with the Financial Adviser has to be laid down by the Ministry itself in its own discretion. Thus, the Ministries are not under any obligation to cousult their Internal Financial Adviser in all financial matters and it is open to them to prescribe the cases or types of cases in which they would consult the Financial Adviser. Further, it is not even obligatory for a Ministry to have an Internal Financial Adviser. In Ministries, where Internal Financial Advisers are not considered necessary, officers of the concerned Expenditure Division of the Finance Ministry will continue to be available for consultation and the Secretary of the administrative Ministry will have the power to overrule such officers of the Finance Ministry also in the delegated field."[11] The most important feature of the present system of delegation is that, theoretically, the scrutiny by the Ministry of Finance is primarily pre-budget. Once such pre-budget scrutiny is completed and the schemes/projects are included in the budget, the administrative Ministries have large powers to incur expenditure, enter into contracts, and generally proceed with the execution. The arrangements should work extremely well if one important condition was satisfied, namely, that the Ministry of Finance did in fact scrutinise most of the schemes/projects at the pre-budget stage.

"The devolution of greater responsibility for financial management and of financial powers to the Ministries", according to the Administrative Reforms Commission, "would involve the acceptance of certain obligations and restraints by the Ministries. First, the Administrative Ministries would have to work in financial matters within the general standard/norms laid down by the Finance Ministry and secondly, the responsibility for expenditure for each department would squarely be on the shoulders of the Secretary of the administrative Ministry who is held accountable for all expenditure. The role and functions of the Financial Adviser, who will under the new scheme be 'internal' and not 'external' to the Ministry as before, assume great importance."[12]

4

The Role of the Financial Adviser[13]

Before explaining the role of the Financial Adviser, a distinction may be drawn between : (1) the External Financial Adviser, whose main

[11]Administrative Reforms Commission, *Report on Finance, Accounts and Audit*. New Delhi, January 1968, p. 26.

[12]*Ibid.*, p. 27.

[13]Adapted from, Administrative Reforms Commission, *Report of the Study Team Financial Administration*. New Delhi, May 1967, Chapter XII.

function is to exercise some of the powers of the Finance Ministry and advise on its behalf; and (2) the Internal Financial Adviser, whose main function is to assist in the exercise of powers delegated to the administrative Ministry.

The aforesaid distinction may further be amplified as follows:

(1) The External Financial Adviser is to be responsible to the Ministry of Finance. While discharging various functions on behalf of the Ministry of Finance, however, there is nothing to prevent his being asked to advise on the delegated financial powers as well. In a sense this would mean a combination of the roles of External and Internal Financial Adviser.

(2) An Internal Financial Adviser, strictly so called (i.e., one who does not exercise any powers whatever on behalf of the Ministry of Finance) confines himself to not only the financial matters finally disposed of by the administrative Ministry but also with those which being outside the delegated powers necessitate a reference to the Ministry of Finance. This, however, is not a combination of roles as in (1) above.

(3) Another distinguishing feature of the Internal Financial Adviser's advice is that it is susceptible to being overruled within the Ministry itself. The level at which it may be overruled and the condition, if any, on which it is overruled are points of relative details, though important in themselves.[14]

Summarizing the latest position, certain financial powers are delegated to the administrative Ministries. In the exercise of such powers it is open to the administrative Ministry : (a) whether or not to make purely internal arrangements for financial advice; (b) in the event of making such arrangements, whether or not they should take the form of appointing an Internal Financial Adviser, strictly so called; and (c) in the event of not appointing an Internal Financial Adviser, whether or not to refer one or more categories of cases, within the delegated sphere, for advice, to the Finance Ministry, it being understood that such advice is not binding on the administrative Ministry.

The role and functions of the Financial Adviser, who, under the new scheme, is to be 'internal' and not 'external' to the administrative Ministry as before assume great importance. "It should be obligatory, in our view, for each Department or Ministry to have a whole-time Internal Financial Adviser of adequate seniority and rank and it should not be

[14]If, for example, it is laid down that every time such advice is overruled, one or more of the various authorities, e.g., Ministry of Finance, Comptroller and Auditor General, etc., should be notified, this would amount to a significant restriction on the exercise of the relevant powers of the administrative Ministry.

left to the discretion of the individual Department or Ministry to decide whether it should have an Internal Financial Adviser. The Internal Financial Adviser should be placed incharge of Finance and Budget Cells of the Ministry and should be responsible for the financial management and control in all matters within the Ministry's field of responsibility and for maintaining requisite liaison with the Finance Ministry."[15]

The Administrative Reforms Commission states further that, "the Internal Financial Adviser should be responsible to and under the administrative control of the Secretary of the Ministry. The Finance Ministry should, however, be required to concur in the appointment of this officer and should have overall and coordinating interest in the development of careers of Financial Advisers. The annual assessment of his work should be made by the Secretary of the Expenditure Department, who should obtain the views and comments of the Secretary of the administrative Ministry under whom the Financial Adviser may, for the time being, be working. While it will be open to the Secretary of the administrative Ministry to overrule him without being required to report the fact to any other authority, the relationship between him and the administrative Secretary should, as envisaged by the Study Team on Financial Administration, be that of senior partners in a common enterprise."[16]

In terms of the existing rules, the administrative Ministry, in respect of the delegated financial powers, can lay down, in its discretion, the procedure for consultation with the Financial Adviser. "In view of the increased delegation to the administrative Ministries and of the dimensions of expenditure controlled by one Ministry, it is necessary that a set of model rules should be framed for the guidance of administrative Ministries in these matters."[17]

Recommendations of the Administrative Reforms Commission

The chief recommendations of the Administrative Reforms Commission on the 'financial control and management'[18] are reproduced below:

(1) It should be obligatory for each Ministry to have a whole-time Internal Financial Adviser of adequate seniority and rank. This officer should be placed in charge of the Finance and Budget Cell of the Ministry and should be responsible for the financial management and control within

[15]Administrative Reforms Commission, *Report on Finance, Accounts and Audit.* New Delhi, January 1968, p. 27.

[16]*Ibid.*

[17]*Ibid.*

[18]*Ibid.*, pp. 28-31.

the Ministry's field of responsibilty. He should not be entrusted with any other work of the administrative Ministry like personnel work or office management, etc. It should be open to the government to entrust one officer with the work relating to more than one Ministry/Department.

(2) The procedure for consultation with the Financial Adviser and the type of cases in which he would be consulted should not be left to the discretion of individual Ministry. A set of model rules should be framed for the guidance of administrative Ministries in this matter.

(3) The Finance and Accounts Branches of the administrative Ministries should be suitably strengthened wherever necessary and staffed with qualified and well trained personnel.

(4) The Finance Ministry should help the administrative Ministries to organise well-equipped internal Finance Branches. For this purpose, it will be necessary to (i) ensure proper training of the junior officers, and (ii) provide for officers in the middle levels suitable opportunities to acquire varied experience and knowledge of public administration.

(5) The Financial Adviser should bring to his assignment a background of field experience and at an appropriate stage he should be given such orientation as to equip him for the role and functions of Financial Adviser. The officers without a similar background should be provided this experience as early as possible in their careers as Financial Adviser.

(6) There should be a provision for periodical interchange between the officers of the Finance Branches and other branches of administration.

(7) If a feasibility report has been accepted by Government and the detailed scrutiny thereof is likely to take considerable time, the administrative Ministry should be allowed to incur expenditure on preliminary work subject to specified financial limits.

(8) A definite time limit, say, three months, should be prescribed for the consideration of schemes by the Finance Ministry. If the decision of that Ministry is not reached within the prescribed period, the case should automatically be put up to the Finance Minister who will decide upon the action to be taken and will communicate the decision to the administrative Minister concerned.

(9) Proposals of the administrative Ministries for additional staff or creation of new posts should be considered by an independent agency namely, a well-equipped and well-trained Staff Inspection Unit.

(10) In cases of sudden unforeseen increase in work due to extraordinary circumstances, the Ministries and Departments should have power to create, only for very short periods not exceeding three months, temporary posts if funds can be found by reappropriation within the existing budget provision. Such powers may be made available to Heads of Departments also.

The system of 'internal finance' under the control of the Secretary of the administrative Ministry/Department is a recent development, and has been introduced on a model now obtaining in the United Kingdom. It has to be recognised that the Secretary of the administrative Ministry/Department is primarily responsible for the efficient and economic functioning of the Ministry/Department under his charge and, therefore, he should have sufficient financial authority for the due discharge of that responsibility. The system now assures that there should not be any difficulty on the administrative side of the Ministry/Department which may arise in the formulation and proper execution of the schemes and projects.

Principally, the accounting responsibilities should be decentralised and should come to be vested with the executive government instead of the Comptroller and Auditor General of India as at present. This involves, however, intricate and complicated problems to be sorted out at various levels before some final decision is taken. Until such time, the system of 'internal finance' would positively help devising techniques as are best suited to keep a watch over the progress of expenditure. Such techniques should aim at the formulation of realistic and valid budget estimates; realistic projections of forward expenditure; keeping expenditure within the limits of appropriation; and keeping expenditure up to the level to reach Plan objectives.

The scheme has, without doubt, gone a long way towards efficient execution of the budget. This is what was required in the context of increasing development activity undertaken in the public sector involving investments of hundreds of crores of rupees year by year. The system of 'internal finance' still, however, leaves a considerable scope for further improvements. The Public Accounts Committee, in its Report on the Finance Accounts of the Central Government (1961-62), remarked that "large savings continued to occur despite the delegation some years ago of financial powers to administrative ministries." The Committee recommended that the Ministry of Finance should examine the feasibility of making more effective the financial control exercised through the financial advisers attached to the various Ministries. The Committee also stressed the need for curbing the tendency of administrative Ministries to overlook avoidable expenditure in the delegated set-up.

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8

Accounts and Audit

In a parliamentary democratic set-up, the executive government, for their functions, are ultimately accountable to the legislature. In financial matters, it becomes incumbent upon the legislature, therefore, to scrutinise and examine critically all the aspects of financial administration by the executive government and to arrive at its own judgement in an appropriate manner. As the examination of intricate government accounts and the scrutiny of the technical soundness of the financial transactions is a specialised task, in the first instance this job is commonly entrusted to an independent organization whose reports are placed before the legislature for the latter's consideration. This organisation is the Audit Department. "Audit, like the judiciary, the executive and the legislature, is one of the important ingredients of democracy. Its primary purpose is to ensure that in the process of expending government funds all canons of financial propriety have been observed, that the rules and regulations which govern expenditures are adhered to, that the expenditure has been incurred by the authority which is empowered to incur it, and that it has been incurred for the purpose for which it has been appropriated by the Parliament. Audit supplies are an essential link between the executive and the Parliament and is helpful in interpreting the action, in so far as they have a financial bearing, of the former on the latter."[1]

[1]Premchand, A., *Control of Public Expenditure in India.* New Delhi: Allied Publishers, 1963, p. 301.

The audit of the financial transactions of the government is, therefore, the most important instrument of parliamentary control over the finances of the nation.

With the passage of time, the government expenditure has increased enormously, grown complex, and become varied and as such increasing stress has to be laid on the accurate accounting and estimation. The examination of the disbursements arising out of appropriations of moneys sanctioned by the legislature to meet public expenditures, therefore, assumes a great importance in order to enforce an effective control of the legislature over the finances of the public authorities. This points out to the need of having an independent audit authority which should be charged with the responsibility of not only to ensure maintenance of accurate accounting procedure but also to see that amounts are disbursed strictly according to the appropriations sanctioned by the legislature and to detect waste and inefficiency.

In India, there is a provision in the Constitution for an independent Comptroller and Auditor General of India (hereafter to be known as CAGI), who not only maintains the accounts of the government in the capacity of an Accountant, but also conducts the audit of all the public moneys disbursed from the Consolidated Fund of India. The performance of both the functions by the CAGI in this country is a historical coincidence. The CAGI is appointed by the President under the Constitution and his statutory duties and powers have been prescribed in the Constitution. The constitutional position in this respect is laid down in the Article 148 which reads as follows :

(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) Every person appointed to be the Comptroller and Auditor General of India shall, before he enters upon his office, take and subscribe before the President, or some person appointed in that behalf by him, an oath or affirmation according to the form set out for the purpose in the Third Schedule.

(3) The salary and other conditions of service of the Comptroller and Auditor General shall be such as may be determined by Parliament by law and, until they are so determined, shall be as specified in the Second Schedule.

Provided that neither the salary of a Comptroller and Auditor General nor his rights in respect of leave or absence, pension or age of retirement shall be varied to his disadvantage after his appointment.

(4) The Comptroller and Auditor General shall not be eligible for further office either under the Government of India or under the Government of any State after he has ceased to hold his office.

(5) Subject to the provisions of this Constitution and of any law made by Parliament, the conditions of service of persons serving in the Indian Audit and Accounts Department and the administrative powers of the Comptroller and Auditor General shall be such as may be prescribed by rules made by the President after consultation with the Comptroller and Auditor General.

(6) The administrative expenses of the Office of the Comptroller and Auditor General, including all salaries, allowances and pensions, payable to or in respect of persons serving in that Office, shall be charged upon the Consolidated Fund of India.

It will be observed that the object of these provisions of the Indian Constitution, is to secure the independence of the CAGI from the control of the executive government so that he can discharge his duties without fear or favour. "The position of Auditor General is unique in many respects. Although he is civil servant by training and though he works with the civil service and his subordinates are civil servants, yet he is not one of them. His constitutional status and duties isolate him and he is in the words of Sir Frank Tribe himself, 'very much a lone wolf'. Unlike any civil servant he has no chief. He has statutory duties and large discretionary powers and though it is his job to aid the House, the responsibility for his actions is his alone."[2] The President makes the appointment to the office of the CAGI on the advice of the Prime Minister. The incumbent of the post is one who has held high positions in the Central government, because a considerable knowledge and wide experience of the administration of the government functioning is considered indispensable for this office.

2

Duties of the Comptroller and Auditor General of India

The duties and powers of the CAGI have been prescribed in the Constitution. According to Article 149 of the Constitution : "The

[2]Chubb, Basil, *The Control of Public Expenditure*. Oxford : The Clarendon Press, 1952, p. 172.

Comptroller and Auditor General shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament and, until provision in that behalf is so made, shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States as were conferred on or exercisable by the Auditor General of India immediately before the commencement of this Constitution in relation to the accounts of the Dominion of India and of the Provinces respectively."[3]

Articles 150 provides that "the accounts of the Union and of the States shall be kept in such form as the Comptroller and Auditor General of India may with the approval of the President prescribe."

Articles 151(1) and 151(2) provide further that, "the reports of the Comptroller and Auditor General of India relating to the accounts of the Union shall be submitted to the President, who shall cause them to be laid before each House of Parliament. The reports of the Comptroller and Auditor General of India relating to the accounts of a State shall be submitted to the Governor who shall cause them to be laid before the Legislature of the State."

An auditor to discharge his responsibilities faithfully must be independent of the executive for he has to examine the financial conduct of the executive. It will be seen, therefore, that the CAGI is completely independent of the executive statutorily and is entirely in the service of the Parliament. The provision, therefore, constitutes a most important step towards effective Parliamentary control of finance. His duties and powers have to be prescribed under the Article 149. Hence he exercises the powers and performs the duties as at the commencement of the Constitution. From Article 150, it will be seen that the statutory duties and powers of the CAGI cover both the accounting and audit of all financial transactions of the Union government. In the matter of accounting his responsibilities are well defined and conform to the traditional functions of an Accountant, except that the form in which the accounts of the Union government are to be maintained is prescribed by him with the approval of the President. The CAGI also submits his audit reports on the Appropriation Accounts relating to the Centre to the President.

As already stated the statutory duties and powers of the CAGI fall broadly in two categories : (1) of an Accountant, and (2) of an Auditor; and these are detailed below :

[3]The legislation envisaged in Article 149 relating to the duties and powers of the CAGI has not yet been enacted by the Parliament with the result that the Government of India (Audit and Accounts) Order 1936, as adapted by India (Provisional Constitution) Order, 1947 continues to delineats these duties and powers.

As an Accountant

(*a*) He prescribes, with the approval of the President, the form in which the accounts of the Union and the State governments are to be kept.

(*b*) He maintains the accounts of the Union and the State governments other than the accounts relating to the Defence and Railways, accounts relating to the transactions in the United Kingdom, and initial accounts kept in Treasuries, and Departments/Offices including accounts of stores and stocks, trading, manufacturing and profit and loss accounts that may be required to be kept in any particular Office or Department. But this does not impair his authority to prescribe the form in which accounts are to be rendered to his offices and the forms in which initial records on which such accounts are based are to be kept. "The Executive Government has power, under the Audit and Accounts Order, to relieve the Comptroller and Auditor General from responsibility for the keeping of the accounts of any particular service or department. Under the terms of this proviso, the Comptroller and Auditor General has been relieved of the responsibility of keeping accounts of certain Ministries at the Centre."[4]

(*c*) He has to prepare each year a comprehensive account of receipts and expenditure of the Union and the State governments. These accounts are known as the Finance Accounts. He has further to prepare annually, a General Financial Statement incorporating a summary of the accounts of the Union and the State governments for the preceding financial year and particulars of their balances and outstanding liabilities and containing such other information as to their financial position as the President may direct to be included in the statement. This General Financial Statement is known as Combined Finance and Revenue Accounts of the Union and the State governments.

(*d*) He has also to submit annually to the Union and the State governments, in respect of accounts kept by him, Appropriation Accounts relating to expenditure brought into account during a financial year according to the several items specified in the Schedules to Appropriation Act.

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[4]Wattal, P.K., *Parliamentary Financial Control in India*, Second Revised Edition, Bombay : Minerva Book Shop, 1962, p. 233.

As an Auditor

(*a*) He is to audit all expenditure from the revenues of the Union government and of the State governments, incurred in and outside India, and to ascertain whether moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or the purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it. His only limitation is in respect of the secret service expenditure.[5]

(*b*) To audit all transactions of the Union and the State governments relating to debt, deposits, sinking funds, advances, suspense accounts and remittance business.

(*c*) To audit all trading, manufacturing, profit and loss accounts, and balance sheets kept by an order of the President; and in each case to report on the expenditure, transactions or accounts so audited by him.

(*d*) To audit receipts, stock accounts, etc., when he undertakes such audit with the approval of or is required to undertake it by the President.

(*e*) To undertake any additional duties, for example, audit of Local Bodies, if required to do so by the President, at his discretion and on agreed terms.

(*f*) To submit his audit reports on the Appropriation Accounts to the President for being placed before the Parliament.

The CAGI has "more freedom in relation to audit of expenditure than in relation to audit of receipts and of stores and stock accounts. Whereas in relation to expenditure he decides the scope of audit and frames his own audit codes and manuals, he has to proceed with the approval of the Executive government in relation to rules for the conduct of the other audits."[6]

Parliament appropriates specific sums for specific purposes. The executive government is expected to keep within the sums so appropriated and to spend them only for the purpose approved by the Parliament and for nothing else. The accountability of the executive to the Parliament in a democratic set-up is obsolute. This accountability in the field of financial administration is secured through the reports of the CAGI. His functions are not merely to ensure that the appropriations made by the

[5]In relation to secret service expenditure, he cannot call for particulars, but has to accept a certificate from the competent administrative authority that the expenditure has been so incurred under his authority.

[6]Wattal, P.K., *op.cit.*, p. 235.

Parliament have not been exceeded without a supplementary vote or that the expenditure conforms to rules, but also to satisfy himself, on behalf of the Parliament, as to its 'wisdom, faithfulness and economy'. Shri Asok Chanda, a former CAGI observes that "an important responsibility of the Comptroller and Auditor General is to uphold the Constitution and the laws in the field of financial administration, and therefore, to disallow any expenditure which in his opinion either violates the Constitution or infringes the law. But a wider and more important responsibility is the examination of sanctions accorded by competent authorities, so as to satisfy himself that these are proper and fulfil the purpose for which the sanctions have been accorded or grants from the legislature obtained. The Comptroller and Auditor General is competent, therefore, to challange any improper exercise of discretion and also to comment on the propriety of the sanctions and expenditure. His role is to maintain the dignity, independence, detatchment of outlook and fearlessness necessary for a fair, impartial and dispassionate assessment of the sanctions of the executive in the financial field. The Constitution has, therefore, made it virtually impossible to remove him from his office."[7]

It is also the duty of the Comptroller and Auditor General to submit reports on the Appropriation Accounts to the President who causes them to be placed before the Parliament. By the term Appropriation Account is meant an account comparing the total grant (original, supplementary, etc.) made by the Parliament for any particular purpose for a particular financial year with the actual expenditure incurred by the government for that year on that purpose. In his reports he not only draws attention to over-spending or under-spending by departments but also criticises actions of government leading to wasteful and extravagent expenditure. He submits his reports to the President who causes them to be presented to the Parliament.

It would be observed that the duties and powers of the CAGI cover both accounting and audit of all the financial transactions of the Union government and the State governments. In the sphere of accounting, his responsibilities are well defined and conform to the traditional functions of an Accountant, with the exception that the form in which the accounts of the Union government and the State governments are to be maintained is prescribed by him with the approval of the President.

In the capacity of an auditor, the authority and functions of the CAGI are more wider and comprehensive than those exercised by professional auditors. An auditor charged with the responsibility of the audit of commercial enterprises, concerns himself primarily with the certification

[7]Chanda, Asok, *Indian Administration*. London : George Allen and Unwin, 1960, p. 245.

of the profit and loss account and the balance sheet of that enterprise. For this purpose, he undertakes the audit of vouchers, cash book, and other related account books and documents. As far as any expenditure incurred is supported by a sanction of the appropriate authority, and so long as it does not contravene the provisions of the Companies Act, 1956, the auditor cannot comment on the propriety of the sanction or on the discretion by these authorities. Apart from these legal limitations, such an auditor may probably be influenced by the fact that his appointment is renewed annually and any expression of opinion that comes into conflict with the board of directors may jeopardize his continuance as the auditor of the enterprise.

Audit by the CAGI is not subjected to any of these limitations. Nothing prevents him to bring to the notice of the Parliament or the State legislature, as the case may be, the impropriety of any action on the part of the executive government, even when its legality is not in question. Nor does his continuance in office depend on the convenience of the executive government. "The special provisions incorporated in the Constitution do not merely underline his position as a servant of the people; they also endow him with appropriate authority in that conception to review the financial administration of the country as a whole."[8]

3

The System of Government Accounts in India

Some General Considerations

An efficient, properly conducted and effective system of government accounts is one of the pre-requisites of an efficient administrative structure of a government. The government accounting has the following main purposes to serve:

(1) accountability, i.e., to give account of stewardship to those entitled to receive it;
(2) to aid the formulation and execution of policy;
(3) to enable the relative economy of operation to be assessed; and
(4) to provide financial information for a wider range of uses including, notably, the compilation and interpretation of national financial statistics.

Some of the pre-requisites of an effective government accounting system may be summarized as follows:[9]

[8] *Ibid.*, pp. 245-246.
[9] United Nations, *Government Accounting and Budget Execution*, New York, 1952, p. 4.

(1) the system should be designed in such a manner as to exhibit compliance with legal provisions;
(2) accounts which show the commitment and disbursement of moneys must be related to budget accounts which embody requests for expenditure. It means that budgeting and accounting must be components of an integral system of fiscal control;
(3) accounts must be set forth in such a way as to permit a determination of the adequacy of custodianship of moneys and assets under the responsibility of administrative officials;
(4) accounts must be maintained on a basis which will permit an independent audit extending to all records, funds, securities and property;
(5) the accounting system should provide a full disclosure of financial results, including the measurement of revenue and the cost of activities, programmes and organizations;
(6) the accounting system must provide the management at all levels with information for planning and direction. This includes, but is not restricted to, cost management;
(7) the accounting system should incorporate effective procedures for internal audit and control of operations and programmes; and
(8) government accounts must be maintained in such a way as to provide information necessary for the economic analysis and planning of governmental activity. This information should be presented in a form which is useful for both execution and legislative purposes.

Furthermore, government accounts, "must facilitate the process of formulating and adopting the budget. They must be useful tools for programme planning and administration and control and must simultaneously reveal the information necessary for formulation and appraisal of the government's economic programme."[10] That means, a system of government accounting must assure 'accountability' and 'management functions'. Accountability means 'legislative liability'—a system of effective control over receipts and expenditures in order to ensure that the receipts of public moneys are properly accounted for and the use of such moneys is for authorised public purposes only. Considerations involving management demand that the accounts are maintained in such a manner as to permit a continued measurement and analysis of the programmes of the government and the efficiency with which they are executed. In the light of the aforesaid, therefore, a system of government accounts must fulfil the following requirements :

[10]United Nations, Department of Economic Affairs, *Budgetary Structure and Classification of Government Accounts*. New York, 1951, p. 31,

(1) government accounts must conform to the setting as in the budget presented to and adopted by the legislature;
(2) maintenance of government accounts should be decentralized;
(3) the system of government accounts should provide for internal audit and control;
(4) the maintenance of accounts should be such that they should show clearly the cost of the various programmes of the government; and
(5) the system of accounts should be adequately flexible.

More precisely, the accounting system of a government should be devised in such a way as to satisfy the needs of accountability to the legislature, the needs of the executive government and the administrative Ministries, including their subordinate agencies. *Firstly*, the system must ensure that a full and reliable account of the executive government's stewardship of the finances is provided to the Parliament. The form of the accounts should, therefore, be such that it should facilitate a proper audit and a purposeful comparison of actuals with the appropriations sanctioned by the Parliament. *Secondly*, the organisation of the accounting system should be in a manner that the executive government is in a position to fulfil its accounting liability to the Parliament. *Thirdly*, the administrative Ministries, their subordinate agencies, and the other operative organisations should devise and operate internal accounting and reporting systems which should suit their individual requirements and properly equipped in order to provide timely information for facilitating sound managerial decisions.

The Accuonting System in India[11]

In terms of the provisions contained in the Article 150 of the Constitution, the CAGI has been vested with the specific authority to prescribe, with the approval of the President, the form of accounts for the Union government and the State governments, and the methods and procedures to be followed by various agencies in discharging their accounting responsibilities. The powers and functions of CAGI in relation to accounts and audit are embodied in Articles 149 to 151 of the Constitution. Article 149 envisaged an Act of Parliament defining the duties and powers of the CAGI in relation to the accounts of the Union government and the State governments. It was also laid down that, until such an Act is passed, the CAGI would continue to perform such functions as were entrusted to the Auditor General of India before the commence-

[11]Adapted from, Administrative Reforms Commission, *Report of Study Team on Accounts and Audit* (Mimographed). New Delhi, September 1967.

ment of the Constitution. As the envisaged Act has not yet been passed, the CAGI continues to exercise his responsibilities in terms of the Audit and Accounts Order, 1936, as adapted by India (Provisional Constitution) Order, 1947.

Accordingly, the CAGI has the overall responsibility for the maintenance of accounts of the Union government and the State governments with the exception of the accounts of the Ministries of Defence and Railways.[12] Precisely speaking, the function of the maintenance of accounts is shared by the CAGI with the Treasuries and the administrative Ministries/Departments/Organisations, except in the case of Ministries of Defence and Railways which have their own accounting organisations. Even though the CAGI has been relieved of the responsibility for the maintenance of the accounts of a specified class or character under the Initial and Subsidiary Accounts Rules, 1937, he continues to retain full and effective control over the form in which the accounts are to be maintained, including those to be maintained by the agencies other than the CAGI. This authority is derived directly from Article 150 of the Constitution.

This constitutional provision is all-embracing and comprehensive. The initiative and responsibility for prescribing the procedures and forms of accounts and the principles lying thereunder lie with the CAGI, subject only to the approval of the President. The scope of the authority of the CAGI covers the totality of accounts, including the accounts of revenue receipts, all subsidiary accounts, accounts of stores and stocks, commercial accounts, and all other records which may be required to be kept by and within the administrative Ministries/Departments/Organisations.

In the light of these functions and duties in respect of the maintenance of accounts, the CAGI is required to complete and submit to the governments concerned annual accounts designated as the Finance Accounts and Appropriation Accounts, containing, respectively, a comprehensive account of receipts and expenditure classified under various heads of account and the actual expenditure during the financial year in relation to the items specified in the Schedule to the Appropriation Act passed by the Parliament. In addition, the CAGI has to prepare and submit to the President a general financial statement incorporating a summary of the accounts of the Union and the States, particularly of their balances and outstanding liabilities, and such other information as may be required by

[12]The other minor and partial exceptions to this general rule are that the initial accounts are maintained by the Treasuries and by the administrative Ministries/Departments and that the subsidiary accounts, the accounts of the stores and stocks and the commercial accounts are maintained, as prescribed by the CAGI, by the administrative Ministries/Departments/Organisations themselves,

the President. This statement is known as the Combined Finance and Revenue Accounts of the Union and State governments. It is also the duty of the CAGI to furnish to the government concerned such information as may be required by the latter in respect of accounts being maintained by him and assist in the preparation of Annual Financial Statement of the Union and the State governments to be laid before the Lok Sabha/State legislature under Article(s) 112/202 of the Constitution.

Compilation

The focal point for primary record of the financial transactions of the government is the Treasury.[13] As an exception, the initial accounts in respect of transactions of certain departments are maintained by the departmental officers themselves. The receipts and payments on behalf of such departments are accounted for in the treasury records in lump-sum and not in details as in the case of receipts and payments for other departments.

A list of payments, supported by the relevant vouchers, is submitted by the Treasuries to their respective Accountant General's Office in two instalments every month. The receipts and payments for the whole month are also recorded and compiled into a monthly cash account at the Treasury and submitted to the Accountant General's Office. Similarly, in cases where payments in lump-sum are recorded in the treasury accounts, the departmental officers compile a detailed monthly account from their initial record and submit it to the respective Accountant General's Office together with the vouchers.

An important stage in the compilation of accounts is the classification of receipts and payments into the various heads of accounts. This is done partly in the Treasury or the administrative Departments where the initial accounts are compiled, and finally in the Office of the Accountant General. The monthly accounts received from the Treasuries and administrative Departments, after they are classified in details, are compiled in the Accountant General's Office in the Consolidated Monthly Accounts of the Union and the States, as the case may be.[14] Progressive figures are also compiled every month for the Union government and for each of

[13]The Treasury is the unit of the fiscal system in India and is located at the headquarters of each district with one or more Sub-Treasuries dispersed at other places in the district. The Treasuries handle the transactions of both the Union and State governments and at places where the Reserve Bank of India, or the State Bank of India, or the subsidiary banks of the State Bank of India, has a branch, the treasury business is conducted by them Even in such cases, the initial accounts are compiled and maintained by the Treasuries.

[14]The transactions of the Union government taking place throughout the country are consolidated by the Accountant General Central Revenues.

the State governments and eventually, the Annual Finance Accounts and the Appropriation Accounts for the whole year are compiled, which, together with the reports of CAGI, are submitted to the President/Governor, who causes them to be laid before each House of Parliament/legislature.

It may be observed that the pattern of the compilation of government accounts follows well-defined lines. It originates at the stage of initial accounts maintained at the Treasury and, in certain cases, by the Departments themselves. The information flows from a large number of originating points to the various Accountants General's Offices where it is classified and consolidated into monthly and progressive figures separately for the Union and State governments, merging finally into the Annual Finance and Appropriation Accounts which are submitted to the CAGI and by him to the respective governments.

The accounting activities within the administrative Ministries/Departments are, of course, not limited to making payments and withdrawals from the Treasury. Each drawing and disbursing officer has the initial responsibility of classifying his transactions with the Treasury in accordance with the prescribed procedures. He also compiles departmental statements every month for submission to the controlling officer. The controlling officer is required to consolidate the figures independently and seek a reconciliation with the accounts compiled in the Accountant General's Office.[15]

Classification

The general structure of government accounts and, in particular, the system of classification of transactions are matters of great significance from many viewpoints. The adequacy and effectiveness of parliamentary review and control over financial administration are determined substantially by the form and contents of consolidated and classified Financial Statements together with the Demands for Grants submitted to the Parliament. Similarly, for the purposes of financial control within the administrative Ministries/Departments as also for analysis of government activities, a meaningful structure and classification of government accounts is one of the most important pre-requisites.

In India, the Annual Financial Statement, commonly known as the Budget, is presented to the Parliament and the State legislatures in

[15]To a certain extent, therefore, duplicate and parallel statements are prepared, one line travelling through the Treasury to the Accountant General's Office, and the other from the drawing and disbursing officers to the controlling officer. The degree of detail in both sets of accounts being more or less identical, the justification for the duplication involved is that it provides a check against errors and omissions and ensures that drawing and disbursing officers keep proper accounts of the moneys drawn by them.

terms of the various Sections and Major Heads of Accounts grouped under them as prescribed by the CAGI with the approval of the President. The Heads of Accounts do not necessarily correspond with the Demands for Grants which are arranged in the Union government and most, if not all, of the State governments in accordance with the individual Ministries/ Departments. As the accounts are maintained, basically, in terms of the Accounting Heads, coordination and correlation between the Demands for Grants and the Accounting Heads are achieved by exhibiting the provision for each demand under the relevant Accounting Heads broken down further into Primary Units of appropriation prescribed by the government. Thus, the structural pattern of the accounts is intimately linked with the process of parliamentary review and authorization of the budget, and as such, it governs as well as it reflects the form in which budgetary data are compiled and presented to the Parliament.

Government accounts are kept in three separate parts : Part I—the Consolidated Fund; Part II—the Contingency Fund; and Part III—Public Account. In Part I, dealing with the Consolidated Fund, there are three main divisions : (1) Revenue, (2) Capital, and (3) Debt—comprising public debt and loans and advances. Part II is self-explanatory with regards to its contents. In Part III relating to the Public Account, there are two main divisions : (1) Debt and Deposits, and (2) Remittances. Each of the divisions of Parts I and III is made up of Sections which are further sub-divided into Major Heads of Accounts. The main unit of the classification of the accounts is the Major Head which is invariably divided into sub-heads which are further sub-divided into detailed heads. The Detailed Heads and the Minor Heads of Expenditure are so arranged in the accounts as to exhibit separately the expenditure under each primary unit of appropriation as prescribed by the government.

One of the important characteristics of the structure of government accounts in India is its uniformity as between the transactions of the Union and the State governments. This notable feature is intended to facilitate comprehension and comparison of the enormous size and variety of the financial transactions of the Union government and the State governments, and the State governments as between themselves, and from one financial year to another. The elaborate and meticulous system of classification of government transactions at different levels of details from Section down to the Detailed Heads is also intended to facilitate effective financial control and periodical review of public receipts and payments by the administrative authorities.

The structure of accounting system of a government must satisfy the needs of legislature, the executive government and the administrative Ministries including their subordinate agencies. *Firstly*, the system must ensure that the legislature receives a full and reliable account of the executive government's stewardship of the funds provided to it. Thus, the form of accounts must be such as to facilitate a proper audit and a comparison of actual results with the appropriations approved by the legislature. *Secondly*, the accounting system should be so organized as to produce readily all information necessary to enable the executive government to fulfil its accounting responsibility to the legislature. *Thirdly*, the administrative Ministries and other operative agencies should have internal accounting and reporting systems suited to their individual needs and equipped to produce timely information to aid them in taking sound managerial decisions. Aiming at these properties of a sound and effective accounting system, the Administrative Reforms Commission has recommended that :[16]

(1) The budget estimates included in the Demands for Grants and the corresponding central accounts compiled in the various Accountant General's offices should be made more compact and comprehensible. *Firstly*, the details containing the breakdown of primary units of appropriation into detailed heads may be eliminated from the central accounts compiled in the various Accountant General's Offices and to the extent considered necessary for administrative purposes be recorded only in the departmental accounts. *Secondly*, in the light of the wider powers of reappropriation now available to the administrative Ministries and consistent with the objective of simplifying the accounting structure, the entire structure of primary units of appropriation may be reviewed by the Ministry of Finance. *Thirdly*, the structure for the Demands for Grants may be simplified by a grouping of individual schemes within a homogeneous programme to the extent feasible and the detailed breakdown for smaller schemes involving an expenditure of, say, less than Rs. 5 lakhs, may not be provided in the budget papers.

(2) The Internal Financial Adviser in each Ministry/Department, with proper assistance at subordinate levels, should be charged with the responsibility for establishing and maintaining an efficient accounting set-up within the administrative Ministry/Department. The accounting set-up should be such as to ensure the timely submission of accounting data and analysis to the executive authorities to assist their managerial performance and should include an efficient organisation for internal audit as well as the employment of modern techniques such as cost accounting and management accounting.

(3) The accounts organizations set-up in the various Ministries/ Departments should compile inventories of immovable property belonging

[16]Administrative Reforms Commission, *Report on Finance, Accounts and Audit.* New Delhi, January 1968, pp. 34-35.

to the government and administered by those Ministries/Departments. A central inventory of the fixed assets of the government as a whole should then be made out in the Ministry of Finance on the basis of the departmental compilations.

(4) The feasibility of introducing modern data processing techniques within the accounting system may be entrusted to an expert committee for detailed examination.

(5) The initiative and responsibility for a review and reorganisation of the accounting system in its various aspects may be located in the Ministry of Finance and a well equipped organization may be set up there for this purpose.

(6) The Comptroller and Auditor General of India may be closely associated with the Ministry of Finance in undertaking a joint programme for improvement in the accounting system.

4

Audit of Appropriation Accounts

The role of audit has, undoubtedly, attained a cruicial importance in the machinery of financial administration of modern parliamentary democracies. It is only through the institution of independent audit that parliamentary control over public expenditure can become really effective in order to ensure that the funds voted by the legislature are utilized by the executive government only for approved purposes and with due regard to considerations of economy and efficiency. The audit of appropriation accounts is to be viewed from the point of scrutiny applied with various points of view, which may be summed up as follows :

(1) Audit from the point of view of accountancy and classification.
(2) Audit from the viewpoint of authority.
(3) Audit of appropriation and finance accounts.
(4) Audit from the point of view of propriety.

Audit of Accountancy

Viewing the audit from the point of accountancy, the auditor of public accounts is expected to perform the same functions as those of an auditor of private commercial accounts. The object is to satisfy about the accuracy and completeness of accounts, to ensure that all revenues and receipts collected by the government are accounted for under the proper heads, that all expenditure and disbursements are supported by proper authorizations, vouched for and correctly categorized, and that final account gives a complete and true picture of the financial transactions it is supposed to. Frauds and technical errors are also to be checked and detected.

The audit of the government accounts in India is continuous, and as far as is possible proceeds alongwith cash transactions. It is prompt and is not postponed till the year is over and the final accounts of the year are completed.

Audit of Authority

"Closely allied to appropriation audit, and necessarily bound up with it, it is the audit of authority or administrative unit : the examination of expenditure with a view to seeing that it is supported by the requisite authority in each case."[17] The Audit and Accounts Order makes it incumbent upon the CAGI to ascertain whether the expenditure conforms to the authority which governs it. "The House appropriates the grants, but the expenditure, even though made on the service for which it is appropriated, is not valid unless incurred under proper authority. The provision made by Parliament (Legislature) for a service detailed in the estimates is not in itself any authority for carrying out that service, if it is a service for which treasury authority is required. The audit of authority is therefore an important function of the Comptroller and Auditor General, and it is his duty to report to the House any unauthorized expenditure for which treasury sanction is unobtainable; and he would normally recommend it for disallowance, but in special circumstances he would use his discretion as to admitting charges which are unauthorized, subject to the review of the Public Accounts Committee, whose attention would be drawn to them in his report."[18]

The basis of all audit and authorities is the Constitution and it becomes, therefore, the duty of the CAGI to watch and ensure himself that all expenditures incurred should be in strict conformity with the relevant provisions of the Consitution and of the laws made thereunder, and should also conform to the financial rules and regulations framed by a competent authority, and that they should be supported by sanction, either special or general, accorded by a competent authority authorizing the expenditure. "In conducting the audit in respect of the audit of authority, the auditor performs quasi-judicial functions, in that he has to apply the rules and orders as they stand, irrespective of the position of the person against whom they are enforced. He may not relax or waive the rules,

[17]Durell. A. J. V., *The Principles and Practice of the System of Control Over Parliamentary Grants*. London : Grieves Publishing House, 1917, p. 186.

[18]*Ibid.*, p. 188; Chubb, Basil, *op.cit.*, pp. 58-59.

except where he is specially empowered to do so."[19]

"In order to enable this audit of authority to be properly conducted, it is essential that regulations should be as explicit as possible. Anything like a wide discretion renders the action of the audit department nugatory, and the Public Accounts Committee deprecates the insertion in regulations of warrants (Orders) of such phrases 'as a rule'; such a limitation obviously does not extend to the delegation of power to be exercised in special cases, for it is impossible to legislate in advance for every case that may arise. For audit purposes it is essential that the regulations should make it clear who the apporving authority is and the limit of his powers. The discretion is then specially defined, and the exercise of it is a matter of administration."[20]

Cases where expenditure has been incurrred in the absence of the approval of a competent authority, together with cases where the expenditure has been incurred in excess of such authority, as they come to the notice of the auditor in the course of audit of authority, are commented upon in the Audit Report for the attention of the legislature and the Public Accounts Committee.

Audit of Appropriation Accounts and Finance Accounts

Appropriation Accounts : Audit of appropriation is, without doubt, the most important part of obligatory audit. It is the primary and foremost duty of the public auditor to see that grants are appropriated for the purpose for which they are provided by the legislature. "The appropriation of the grants to specific purposes is the expression of the will of Parliament, which becomes law on the passing of the Appropriation Act. Deviations therefrom consequently diminish parliamentary control, even though specially legislated for in certain cases, because Parliament can only be able to give an *ex post facto* sanction to them. The strictness with which appropriation is applied is the measure of parliamentary control. No grants may be exceeded without fresh parlimentary authority accorded by a supplementary estimate or an excess grant, except in those special cases in which the Treasury (Finance Ministry/Department) is empowered to exercise, temporarily, modified powers of virement (reappropriation), subject to final approval by the House. The money must be spent within the time for which it was granted, and no sums are chargeable against the grants which do not actually come in course of payment within the financial year, a natural sequence of this condition being that any unspent surplus must be surrendered. Every amount charged in the account must be

[19]Government of India, *Introduction to the Indian Government Accounts and Audit*, New Delhi, 1954.

[20]Durell, A. J. V., *op.cit.*, p. 188; Chubb, Basil, *op.cit.*, p. 53, footnote.

supported by proof of payment, the Comptroller and Auditor General being the subjudge of the sufficiency of evidence of payment."[21]

The importance of appropriation audit demands that such an audit must be a detailed and complete one. In this connection, a test audit cannot be substituted for a through audit. Each disbursement must be checked into the books right upto its proper head of service so as to ensure that the intention of the legislature is duly carried out. These intentions are expressed in the estimates as finally granted by the legislature. The estimates, therefore, form the basis for the appropriation audit. "The audit functions, however, vary with different parts of the estimates. The appropriations specifying the total amount voted for each grant are the primary concern. The major heads of account come next in order of importance, the next come the minor heads and sub-heads, and last of all come the detailed heads. The Comptroller and Auditor General holds and always has held that the estimates (including the parts) are put before him as a whole; that although they are divided into three parts, yet, in as much as Parliament grants the money on the understanding that it is going to be spent in that manner, the department presenting those estimates to Parliament cannot repudiate the responsibility for the divisions under which it represents them, and upon faith on which Parliament grants the money. Therefore, the Comptroller and Auditor General holds that the estimates are put before him as a whole; that he is entitled, if he thinks proper, to question any deviation from the estimates as shown by the figures giving details of expenditure."[22]

More specifically, audit of appropriation accounts underlie two main objectives, viz., 'defective budgeting' and 'keeping expenditures within the scopes of grants sanctioned by the legislature'. As regards defective budgeting, the auditor is required to review and comment upon: (a) expenditure that has exceeded the voted grants and charged appropriations that is not covered by supplementary grants and appropriations; (b) supplementary grants have been obtained during the course of the year but having proved unnecessary eventually; and (c) amounts which have been surrendered unutilized *or* reappropriations which have proved to be excess or unnecessary. The comments of the auditor become reminders to the executive government that further improvements in the preparation of the budget are called for and better control over expenditure should be exercised. Coming to the 'keeping expenditures within the scopes of grants sanctioned by the legislature': (a) the moneys recorded as having been spent against a particular grant

[21]Durell, A. J. V., *op.cit.*, p. 182-3.

[22]Mukherjea, A.R., *Parliamentary Procedure in India*, Second Edition. Calcutta: Oxford University Press, 1967, pp. 333-334.

must not exceed the amount so granted and that the authority sanctioning such expenditure should not sanction amounts in excess of those available under the grant; (b) that the expenditure recorded against a particular grant must be of such a character so as to entitle itself to be recorded as such; (c) that the moneys have been appropriated for the purposes which are set out in the demands for grants; and (d) no expenditure has been incurred on any new service which was not contemplated at the time of passing the budget.

It may be recalled that under the provisions of the Constitution,[23] the expenditure charged upon the Consolidated Fund is required to be shown separately from that which has been voted, and also that expenditure on revenue account is to be shown separately from capital expenditure. "It is, therefore, an important function of Audit to verify that no expenditure is classified as 'charged on the Consolidated Fund' except in accordance with the terms of the Constitution and conversely that no expenditure is classified as voted which should be 'charged".[24]

As regards the classification of expenditure, the allocation between revenue expenditure and capital expenditure is very important; otherwise the aggregate financial picture shall present a misleading account. "It should be borne in mind that the decision whether expenditure shall be met from current revenues or from borrowed moneys rests with the executive subject to the approval of the legislature. It is, however, the duty of Audit to bring to notice occasions on which the classification of expenditure between revenue and capital or its distribution between current revenues or loan funds appears to be contrary to the dictates of sound and prudent financial administration. The financial and accounting conception of capital expenditure is imported from commercial theory and practice and an essential feature is that expenditure of a capital nature is not met from the revenue or profits of a concern. The essential purpose of the opening of capital heads of account is to facilitate the exhibition of financial results of any special undertaking on the basis of generally accepted commercial principles or in some more simple conventional manner, either that the cost of a service may be ascertained or that the full financial implication of any policy may be made clear."[25] Quite often, the executive government decides to finance capital expenditure from revenue accounts, but that too should be properly recorded. The main purpose of recording capital expenditure, which is financed out of revenue account, as separate and distinct from revenue expenditure is almost always to enable accounts to be maintained according to commercial principles.

[23]Articles 112 and 202.
[24]*Audit Code.*
[25]*Ibid.*

Finance Accounts : The auditor's report on the appropriation accounts concerns with that part of the government expenditure which is sanctioned by the legislature in the form of Demands for Grants. The auditor's report on Finance Accounts comments upon the salient features of current revenues and expenditures, the financial performance of important public works, the debt position distinguishing between productive debt and unproductive debt and the arrangements for redemption of such debts including comments from their adequacy or not. The auditor's report contains a review of the balances of Public Debt, Deposits, and Remittance Heads. This review is made with the objective of : (a) showing a comprehensive enumeration of the balances under all Debt, Deposit, and Remittance Heads; and (b) examining and setting out the correct state of account under each head. Precisely, the auditor's report on Finance Accounts presents a true and correct state of affairs of the financial position of the government as reflected by the accounts of the government.

Audit of Propriety

Viewed from the point of regularity, an expenditure may be in order if it satisfies the aforesaid three tests, i.e., it is a properly vouched expenditure, carries the sanction of a proper authority, the rules have been observed both by the disbursing and sanctioning officers, and that it is being met from the grants sanctioned by the legislature and recorded under the relevant head of account. Notwithstanding all these formalities having been observed regularly, cases involving extravagance and waste may arise. Such expenditures are termed as improper expenditures. Similarly, there may be improper use of stocks and stores. Canons of sound financial administration require that a review of the expenditure from this angle must also be made. Audit being an instrument of financial control, the auditor must bring all cases of extravagance and waste to the notice of the legislature. This is known as 'higher audit' and require a considerable amount of tact and discretion on the part of the auditor. The principle underlying such an audit is that 'every government official must exercise the same care in respect of expenditure of public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money'. In such a sphere of audit, the auditor is expected to look beyond the vouchers and scrutinizes certain aspects of expenditure which fall beyond the formal audit, in order to assure himself about the wisdom, faithfulness and economy in such an expenditure. In this connection, due consideration is given to two particular points : (a) no expenditure should ordinarily be sanctioned which would benefit the personal cause of the authority sanctioning such an expenditure directly or indirectly; and (b) no moneys should ordinarily be spent which would benefit a particular person or section of the society unless *either* the amount of expenditure involved is insignificant, *or* a claim could be established in the court of law, *or* it is in conformity with a policy or a custom.

However, the functions of the CAGI in this respect have not precisely been defined. Durell opined that such functions of the Comptroller and Auditor General fall within the range of the 'discretionary review', and the limits of such review are governed more by usage and precedent than enactment. "This practice of drawing attention to cases of extravagance is a good instance of a development of procedure arising out of the system provided by Parliament, but not specifically legislated for."[26] The Comptroller and Auditor General may be asked to investigate into the methods of expenditure involved in the consideration of the purpose for which it was made, and consequently to probe into the elements of extravagance, and also to report on the accounts.

"This accepted view of the practice which has grown up is a wise one in the interests of national finance, if not carried too far. If, however, the Comptroller and Auditor General was to set up as the central authority for reviewing expenditure generally, and its necessity, it would create friction, and in the end do more harm than good. If he reports on a matter of administration from the point of view of its effects on the public purse, it will be for the purpose of bringing before Parliament something which would otherwise pass un-noticed. It is impossible to deny that it is always his right, and will often be his duty, to take this step; but it is equally obvious that the occasion and manner of such reports must be matters of discretion. The success of the practice, and its consequently beneficial rusults, are due to the moderation and tact with which it has hitherto been applied."[27]

It becomes obvious, therefore, that in this field of discretionary review, the duties of an auditor are incapable of being regulated by legal enactment *or* by laying down precise rules. The Auditor General's rules framed under the Government of India Act, 1919, provided for some 'canons of financial propriety'. "There are no such statutory canons now; but audit may challenge expenditure"—otherwise regular, not on the basis of any such canon but "as transgressing a universally accepted standard of official conduct or financial administration."[28]

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[26]Durell, A. J. V., *op.cit.*; Chubb, Basil, *op.cit.*, p. 61.

[27]*Ibid.*

[28]Pinto, P. J. J., *System of Financial Administration in India*. Bombay : New Book Company, 1943, p. 264.

5

Audit of Public Sector Undertakings

With the increasing participation of the State in the industrial and commercial activity during the last more than two decades, it has been found necessary to employ new forms of organisation to equip the public sector commercial and industrial undertakings, with a reasonable degree of autonomy and flexibility in their operations. This has led to the establishment and organisation of two distinct types of undertakings which derive their finances from the State, but because of their essentially industrial and commercial character are not subject to normal government rules and procedure.[29] These distinct entities are : (1) corporations set up by special acts of Parliament, popularly known as 'statutory corporations",[30] and (2) joint stock companies registered under the Companies Act, 1956, known as 'government companies'.[31] The development is not altogether unprecedented, for even before the advent of the planned economic development, the government had controlled public corporations. The crux of the problem which the government and the Parliament between them have come to face during the last twenty years had arisen from the sudden increase of the extent of the responsibility arising from the large scale investment of public moneys into such corporations.

[29]The traditional types of public enterprises had hitherto been what are commonly known as departmental undertakings like railways, post offices, telegraph and telephone services, harbours; commercial and industrial monopolies of a revenue raising character, etc. Such enterprises are generally organised, financed and controlled in much the same way as any other government department; are financed by annual appropriations; a major portion of their revenue finds its way into the budget; and they are subject to budget, accounting and audit controls applicable to the Ministries/ Departments.

[30]The statutory corporations of the Union government are : Agricultural Refinance Corporation; Deposit Insurance Corporation; Employees State Insurance Corporation; Industrial Development Bank of India; Industrial Finance Corporation of India; Life Insurance Corporation of India; Reserve Bank of India; State Bank of India; Unit Trust of India; Air India; Indian Airlines Corporation; Food Corporation of India; Central Warehousing Corporation; Oil and Natural Gas Commission; and Damodar Valley Corporation.

[31]As at March 31, 1968, the total number of government companies at work was 241 with an aggregate paid-up capital amounting to Rs. 1532 crores. Of these 85 were Central government companies and the remaining 156 were State governments companies. Important government companies are : Hindustan Steel; Bokaro Steel; Heavy Engineering Corporation; National Coal Development Corporation; Neyveli Lignite Corporation; Indian Oil Corporation; Fertilizer Corporation of India; Bharat Heavy Electricals; Heavy Electricals (India); and Hindustan Aeronautics.

It was quite obvious, from the very necessity of creation of such statutory corporations/government companies, that such entities could not be treated, from the point of view of parliamentary control of their finances, in the same way as the departmental undertakings of the government. The bodies responsible for the management of such enterprises had to be allowed a higher degree of independence for financial action.

Audit of Statutory Corporations

The statutory corporations, described by Herbert Morrison as "a combination of public ownership, public accountability and business management, for public ends" are governed by special laws defining their powers, duties and immunities and prescribing their form of management. They are mostly free from regulatory and prohibitory statutes applicable to the expenditure of public funds and are not ordinarily subjected to budgeting and audit procedures applicable to Ministries/ Departments or departmental undertakings. That was, perhaps, the over-riding reason that these corporations are exempted from submitting to the Parliament annual estimates of their proposed expenditure. The budgets, of such corporations are not voted by the Parliament; only the total grants in respect of their capital investment programmes financed by the government are voted. It becomes all the more important, therefore, that the undertakings financed from the Consolidated Fund do not whittle away parliamentary control over public money and that large sums of public money should be taken out of parliamentary control.

The development raises a vital point in that to what extent the Parliament should be authorized to scrutinise the accounts of such statutory corporations in order to ensure that these enterprises, in which large amounts of public moneys are invested and whose ambitious expansion programmes during the successive Five Year Plans would involve a still larger draft on the public exchequer, do not employ their financial resources wastefully. The problem in their case is that there is no specific appropriation for the amounts granted for capital investment and obviously there could be no question of ensuring that money was spent in accordance with appropriation. "Having initially provided the funds required to set up the undertakings and having bestowed on them the necessary autonomy and flexibility in operation, Parliament has a responsibility to see that the funds are utilized properly and efficiently, as in the case of departments and units in the purely governmental sector. This is the least that the Parliament owes the people whose chosen representatives sit in it. In fact, one might even argue that, considering the size of public funds provided to these bodies and the implications of the autonomy allowed to them, Parliament has a greater duty and responsibility in regard to corporate enterprises than in the case of departmental units. The principle of the accountability of publicly-owned autonomous undertakings to Parliament, and through it to the public, has, therefore, to be accepted; it cannot be made a matter of controversy."[32]

The accountability of such autonomous statutory corporations is, therefore, assured by their relevant statutes providing for the maintenance of accounts as prescribed and their audit by an independent authority. *Firstly*, there are corporations like Air India, Damodar Valley Corporation, Indian Airlines Corporation, Oil and Natural Gas Commission, in respect of which the responsibility of audit has been entrusted entirely to the CAGI. *Secondly*, there are other corporations like Industrial Finance Corporation of India, the Central Warehousing Corporation, whose audit is done by professional auditors (private firms of chartered accountants). These auditors, or one of them if there are two or more, are appointed by the Central government in consultation with the CAGI who has the right to undertake such audit as he may consider necessary either of his own motion or on a request from the government. *Thirdly*, there are other corporations like the Reserve Bank of India, the State Bank of India, Life Insurance Corporation of India, Food Corporation of India, for which the audit is done exclusively by the private firms of chartered accountants and the CAGI does not come into the picture at all. All these corporations are required to submit their annual reports and accounts directly to the Parliament so as to render such financial statements subject to scrutiny by the Public Accounts Committee/Committee on Public Undertakings of the Parliament.

It will be observed that either the audit control is exercised by the CAGI, *or*, where the private firms of auditors, qualified to conduct audit under Section 226(1) of the Companies Act, 1956, are appointed, such appointment is done by the Central government, generally in consultation with the CAGI, *or*, the CAGI may not have any say. "We are not aware of the special circumstances which necessitate a varied approach to the role of the Comptroller and Auditor General's audit in relation to statutory corporations. We suggest that the association of the Comptroller and Auditor General with the audit of such Corporations should be the normal rule which should be dispensed with only in very unusual and compelling circumstances."[33]

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[32]Mehta, Balwantray, "Public Enterprises and Parliamentary Control", in the *Indian Journal of Public Administration*, Vol. IV, No. 2. New Delhi, April/June 1958, p. 145.

[33]Administrative Reforms Commission, *Report of Study Team on Accounts and Audit*, (Mimographed). New Delhi, September 1967, p. 289.

The annual reports of these undertakings are, under their statutes, caused to be laid on the table of the Parliament and become automatically subject to examination by the Public Accounts Committee/Committee on Public Undertakings. The Public Accounts Committee/Committee on Public Undertakings, however, gets the material for its *post facto* examination of the working of the corporations from the audit reports which may be considered as not very suitable way of judging the work of these enterprises, since the only aspect touched upon is adherence to financial procedure in the concerns.

Audit of Government Companies

Like statutory corporations, the annual budgets of government companies are also not subject to vote by the Parliament. Only the total grants in respect of their capital investment programmes contributed by the government, in the form of either the purchase of share capital or grant of loans, are subject to vote every year. Under Section 619(2) of the Companies Act, 1956 the auditors, private firms of chartered accountants, of the government companies have to be appointed or reappointed by the Central government on the advice of the CAGI. Sec. 619(3) of the said Act empowers the CAGI to direct the manner in which the company accounts shall be audited by the auditor so appointed[34] and to conduct a supplementary or test audit by such persons as he may authorise in this behalf. The observations of the CAGI arising out of this supplementary audit are incorporated in the Annual Audit Repotr (Commercial) submitted by him to the Parliament under Article 151 of the Constitution. The report contains a general review of the working of the government companies followed by a more comprehensive review of the working of some of the companies.

The annual financial accounts of the government companies are caused to be laid by the administrative Ministries/Departments on the table of the Parliament and become automatically subject to examination by the Public Accounts Committee/Committee on Public Undertakings. Any supplementary reports or comments that the CAGI may make are also placed on the table of the Parliament alongwith the annual financial accounts. Section 619(4) provides that the auditors of the company shall submit a copy of his audit report to the CAGI who

[34]The latest directive issued by the CAGI in December 1965 requires the professional auditors to answer certain specific questions regarding the system of accounts and book-keeping, internal control, manufacturing and production accounts, profit and loss account, and the different elements covered in the balance sheet. It also requires the professional auditors to give other significant information indicating the financial status of the company as well as the general analysis of the accounts indicating capital formation, growth of the company, and sources and uses of funds.

shall have the right to comment upon, or supplement, the audit report in such manner as he may think fit.[35]

The concern of the CAGI at every step of the mode and conduct of the audit of the government companies as provided statutorily originates from the primary need of parliamentary control over public money, and is justified on all canons of scrupulous financial administration. It will be noticed that Section 619 of the Companies Act empowered the CAGI to have a considerable discretion in devising the forms in which the accounts of the government companies are to be audited and also to conduct a supplementary audit, requiring as a consequence the annual accounts of these companies having to be subject of close scrutiny by the Public Accounts Committee/Committee on Public Undertakings. "The imposition of these additional obligations on government companies appreciably enlarges the scope and incidence of legal accountability in respect of these companies, and to that extent, it may be *prima facie* claimed, that in its application to government companies the concept is perhaps somewhat wider and deeper. For, it may well appear that the management of government companies is answerable not only to their primary organs but also to another authority outside their structure."[36]

"This *prima facie* view is not, however, strictly correct, in as much as the answerability of government companies to Parliament via the Comptroller and Auditor General, as envisaged in Section 619 of the Companies Act, would appear to stem not so much from the position of Parliament as the shareholders of the government companies as from its primary character as the guardian of the public interest. In other words, it is legitimate to take the view that according to the strict interpretation of the theory of corporate accountability, the additional requirement as to the accountability of government companies as laid down in Section 619 of the Companies Act, is more an incident of the constitutional position of Parliament than an extension of the scope of the shareholders' right to

[35] "Generally speaking the scope of private auditing is much narrower than public auditing. Chartered Accountants unlike the Comptroller and Auditor General, are not concerned with efficiency audit. They are not supposed to criticise wasteful expenditure so long as there are no irregularities. They are not concerned for instance with the failure of National Board to accept the lowest tenders. The ordinary professional accountant would not consider it to be within his term of reference to mention such things in his report. Above all, private firms of auditors would not be interested in the question whether the Public Corporation has spent its money in accordance with Parliament's intention." (Paul Einzig, *The Control of the Purse*. London : Secker and Warburg, 1959, p. 319).

[36] Mazumdar, D.L., "Accountability in the Corporate Sector", in the *Indian Journal of Public Administration*, Vol, IV, No. 1. New Delhi, January/March, 1958, p. 60.

demand answerability from those in charge of the affairs of government companies."[37]

It appears, however, that two parallel sets of auditors now conduct the accounts of these companies. *Firstly*, the statutory auditors of the companies who audit the accounts according to the principles of commercial audit. *Secondly*, the CAGI who conducts the examination of the same accounts more or less on the principles of financial audit applicable to government departments. This overlapping necessarily points towards a need for rationalising and streamlining the existing arrangement. These and many other differences between auditing by private firms and that by the CAGI are not necessarily inevitable. A suitable convention, therefore, has to be evolved which shall provide for a reasonably clear demarcation of the responsibility between the statutory auditors of the government companies and the CAGI. The statutory auditors can be utilised, as originally contemplated, to the maximum possible extent, for carrying out those aspects of the audit of government companies in which the CAGI is particularly interested. The CAGI would, therefore, be made free to devote himself to those special aspects of the accounts of government companies which, generally speeking, in his opinion needed scrutiny from the norms of the accountability of these undertakings to the Parliament.

The Study Team on Accounts and Audit and the Study Team on Public Sector Undertakings, set up by the Administrative Reforms Commission,[38] have put up certain important recommendations in respect of the audit of public sector undertakings, which are summarized below :

(1) The association of the CAGI with the audit of statutory corporations should be the normal rule which should be dispensed with only in very unusual and compelling circumstances.

(2) The CAGI's audit and the audit of the firms of chartered accountants may be so coordinated that the audit staff from both sides can visit the organization at or about the same time and the annual accounts can be finalized expeditiously and with the minimum strain on the management. Moreover, the work assigned to the professional auditors should be clearly defined and distinguished from that done by the Directorate of Commercial Audit in order to minimize the chances of duplication of the functions of the two organizations.

(3) The practice of closing accounts half-yearly and of concurrent

[37]*Ibid.*

[38]Administrative Reforms Commission, *Report of Study Team on Accounts and Audit*. New Delhi, September 1967, and the *Report of the Study Team on Public Sector Undertakings*. New Delhi, June 1967.

audit by the firms of chartered accountants may be adopted wherever feasible, to facilitate the early completion of annual accounts.

(4) The CAGI should take all steps necessary to develop the requisite degree of competence and expertise within his organisation for the effective conduct of efficiency audit of public undertakings. If an organisation is to undertake the task of efficiency-cum-propriety audit, it is essential that its staff should at least resemble, in expertise and specialization, the management organisation of the enterprise concerned. The office of the CAGI should devise, where necessary, suitable procedures and associate technical experts, senior administrators and economists and cost and chartered accountants in this endeavour. There is the need to revise and reorient the attitude of the auditors from the CAGI's organisation to conform to the special requirements of public sector commercial and industrial undertakings.

(5) The work that is at present being done by the Directorate of Commercial Audit should be divided amongst four or five audit boards, each audit board dealing with a particular major area of enterprise like iron and steel, engineering, chemicals, trade and commerce, transport, etc. The existing departmental set-up of the Directorate of Commercial Audit may be utilized for providing secretariat and investigating staff to the audit boards.

(6) While it seems inevitable that audit should be connected with individual instances of waste and extravagance, it is recommended that they should also endeavour to assume a more positive role in reviewing the adequacy of the various rules and regulations and suggesting ways and means of improving the organisation and methods of work of the public undertakings.

The improvements suggested would, no doubt, go a long way in strengthening the existing arrangements which assure due accountability to the Parliament as well as leave sufficient amount of autonomy and flexibility in the day-to-day working of the undertakings.

6

Combination of Accounts and Audit Functions

A notable and unique feature of government accounts in India is the combination of the compilation of accounts and audit responsibilities in the office of the CAGI in respect of not only the Union government but also the State governments. The special feature of Indian system owes its origin to past traditions of a highly centralized form of government under British rule. So strong has been the hold of this historic system that despite all the far-reaching political changes in 1919 and 1935, and even under the Constitution of the Indian Republic, its essential framework has survived a series of powerful onslaughts from time to time. At present, there are only two major organisations, the Defence and Railways, in respect of which the CAGI has no responsibilities in the maintenance and compilation of accounts. In the case of Defence Organisations, the accounts are maintained by a separate agency under the control of the Ministry of Defence, and in the Railways, the accounts are the responsibility of an internal agency which forms an integral part of the railway administration. The accounting functions have also been partially separated from Audit in the case of a few Ministries and organisations since April 1955 under a special scheme on an experimental basis. The scheme was initially introduced in the Department of Supply in the Ministry of Works, Housing and Supply and the Departments of Food and Rehabilitation, and was latter extended to Lok Sabha and Rajya Sabha.

To a person not steeped in Indian practice, the combination of the accounts and audit functions—except in regard to Railways and Defence Services, a few Central Ministries, the Lok Sabha, and the Rajya Sabha—would seem highly incongruous. Accounting is essentially an executive function and must be under the control of the executive head of the Department. Auditing is a quasi-judicial function which involves a checking of the financial transactions of the executive authorities for report to the legislature.[39] A combination of these two essentially distinct functions in an officer who is responsible only to the Parliament is good neither for the executive administration nor for Parliament.[40] It is almost as bad a combination as that of executive and judicial functions. In each modern administration, accounting and auditing functions are kept distinct and separate from each other. It is only then that the auditor's certificate regarding the correctness of the accounts has any meaning. The Comptroller and Auditor General himself has several times brought up this point before the Public Accounts Committee. In the proceedings of the Committee held on January 19, 1951, he was reported have stated : "with regard to the separation of audit from accounts, the Comptroller and Auditor General expressed the view that this was a very important problem and in no country of the world his counterpart was required to maintain accounts

[39]Wattal, P.K., *op.cit.*, p. 237.

[40]Even the British who introduced this system in India did not follow the practice in their own country. In U.K. each Department of State has its own accounts officer and he works in subordination of the Minister-in-charge of the Department. The Audit is a separate department altogether, presided over by the Comptroller and Auditor General, who has nothing to do with authorisation of payments or compiling the accounts. He is only to scrutinise the financial transactions of the Departments.

in addition to carrying out audit functions. He said that the principle of entrusting functions to the Comptroller and Auditor General was quite wrong and detracted considerably from the responsibility of the administration itself for rendering accounts. It was the duty of each administration to keep its accounts, to watch the progress of expenditure so that it functioned properly and effectively. The administration will be a live organisation only when the excessive central financial control was eliminated and more responsibility in the field of financial control and accounts was delegated to them."

Even the Public Accounts Committee in their Third Report of December 20, 1952, stated : "The function of payment of monies, and maintenance of initial accounts is that of the Executive authorities, and it is well-known and universally accepted that the agency which has to audit payments should be separate from and independent of the agency which has to make disbursements, as a combination of these functions is likely to facilitate frauds and embezzlements and prevent their coming to light. This places the Comptroller and Auditor General in a most embarrassing and anomalous position. It is fundamentally wrong in principle, therefore, to make the Indian Audit Department responsible for making payments. The Comptroller and Auditor General has informed the Committee that he as well as his predecessors have been protesting to Government from time to time against the impropriety of his Department being made responsible for pre-audit and Treasury payment work and pressed for its being relieved of pre-audit and payment work. This work is constitutionally entirely outside the duties of his Department. But unfortunately the various Governments have not realised this impropriety nor the risks involved in the arrangement and, therefore, have not implemented the proposal of the Comptroller and Auditor General except in the recent instance of the establishment of the New Delhi Treasury during this month. The Committee endorse the views of the Comptroller and Auditor General that his Department should be relieved of this work without the least possible delay, and recommend that urgent steps should be taken to that end by the governments concerned."[41]

The usual grounds on which the tranfer of accounts from the CAGI is supported may be summarised below :

(1) The present system, under which the Accountant General makes the final compilation of accounts, results in inadequate control over voted grants and appropriations. If the monthly and annual compilation of accounts are made by the spending Ministries/Departments, they will be intimately aware of the flow of expenditure and will thus also be

[41]Public Accounts Committee, *Third Report on Exchequer Control Over Public Expenditure*, New Delhi : Parliament Secretariat, December 1952, pp. iii and iv.

able to exercise better control over expenditure to ensure that excesses over parliamentary grants and appropriations are avoided and the savings minimized.

(2) Final compilation of the accounts within the administrative Ministries/Departments will speed up the preparation of monthly and annual accounts and enable Appropriation Accounts being presented to Parliament earlier than at present. "At the present time, there is some duplication, as the departments keep some statistics themselves, which are, however, regarded only as rough and ready. Experience has shown that the difference between these rough and ready statements and the 'actuals' compiled in the Accountant General's Office can be substantial. It is difficult, therefore, to understand what purpose the departmental accounts really serve if discrepancies persist for a long period after the accounts of a year have been closed. Also, since the accounting organisations are separate from the administrative, there is a tendency on the part of the latter to restrict consulting accounts authorities to the minimum extent possible. In other words, accounting tends to be done more for the sake of accounting itself and the main use which the administration makes of accounts is during the preparation of the budget estimates, when the actuals of a certain number of years have to be inserted, to help in framing the estimates."[42]

(3) An essential concomitant of the departmentalization of payments will be the centralization of payments after complete pre-check. Complete pre-check is decidedly better than the Treasury checks that are being exercised as at present. With centralization of payments, it will also be possible to watch the progress of expenditure under specific heads from day to day so as to effectively guard against expenditure being incurred in excess of parliamentary grants and appropriations.

(4) Payment and accounting are essentially executive functions and the combined responsibility for these should squarely remain with the administrative Departments. A division of responsibility in this regard between the Audit and Accounts Department on the one hand and the administrative Ministries/Departments on the other tends to weaken the efficiency of the financial system.

(5) It is wrong in principle that the authority responsible for auditing the accounts should also compile the accounts which he is called upon to certify. The present system, combining the two functions in the same authority runs counter to the concept of the independence of audit.

(6) At present the Accountants General not only compile accounts, but they also authorize certain types of payments, including payments of a personal nature like pay, leave salary, pensions, etc., which are quite

[42]Ghosh, O.K., *The Indian Financial System*. Allahabad : Kitab Mahal, 1958, p. 93.

often subject to considerable delays putting the officers in avoidable hardships.

The arguments put forward in favour of the existing arrangements are as follow :

(1) Accounting and audit functions are interrelated. The pre-check of drawings before admitting them for payment, the examination of contract documents, etc., with reference to sound canons of financial control are essentially audit processes. "As a matter of fact, the bulk of the audit is done when vouchers are checked up with orders, etc., before being incorporated in the accounts. If at that stage major weaknesses are detected, then inspection staff visit the places concerned and try to get as complete a picture as possible of irregularities and defects. If accounting is separated from audit then audit authorities would not have this close knowledge."[43]

(2) An audit, independent of the executive, is absolutely necessary in order to ensure that the internal accounting organisation is not pressed by the executive for admitting questionable claims and allowing irregular practices. Where the accounting organisation is itself independent of the executive, there does not appear to be any objection to the combination of the two functions.

(3) Payments are always initiated by the administrative Ministries/ Departments and the cash handed over by the Treasury/Bank after what is called the Treasury check. The accounts for the amounts thus drawn are also maintained by the departmental officers who submit a summary of these accounts to their controlling officers. The compilation of the monthly accounts by the Accountant General need not affect in any way the departmental responsibility for payments and accounting.

(4) The Accountant General who merely compiles the final accounts is not subordinate to the Executive, nor does he, in fact, control or direct the accounting set-up within the administrative Ministries/Departments for maintaining departmental records of payments and receipts. It is important to remember in this connection that the departmental authorities are required to maintain a parallel set of accounts for internal use and the Accountant General is primarily concerned with compiling the final accounts on the basis of the vouchers received after payments have been made. There is, therefore, no real anomoly in the present accounting and audit functions of the CAGI.

(5) Under the existing set-up, certain obligations in the sphere of accounts have been imposed on the CAGI. As such the consolidation of departmental accounts and the compilation of finance accounts of the Union and State governments must be attempted as a whole. This

[43] *Ibid.*, p. 95.

coordinating role implies that uniformity in accounting principles and processes in the units, dispersed in the various Ministries/Departments, must be maintained. This can be assured only if the two functions are combined in one authority.

It will be observed that there are sound arguments both in favour of the separation of accounting function from that of audit and in favour of the existing arrangements. The separation of audit from accounts and the provision, organisation and set-up of the necessary accounting organisation under the direct supervision and control of administrative Ministries/Departments and the consequent enforcement of effective control of the Exchequer has, however, the full backing of the theory of financial administration and consequently the reform is long overdue. But the proposed reform does not warrant undue and hasty action in view of the enormous problems which will have to be solved before transferring the accounts to the executive. To quote Shri Asok Chanda again, "the departmentalisation of accounts will require arrangements for the consolidation of these accounts and their compilation into the combined finance and revenue accounts of the Union and the State governments as a whole. It will be necessary to ensure that uniformity in accounting principles and procedure is observed in the units dispersed in the Ministries. Coordination between the Union and the States will have to be provided for. The question whether adequate and efficient audit can be provided by an agency, unfamiliar with the departmental structure of accounts and of rules and regulations of special application, also becomes important and relevant in this consideration. The formation of linguistic States, when the business will be conducted in the regional languages is likely to create yet another problem. On the balance it seems advisable that changes should not be initiated until the future becomes defined."

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9

System of Financial Committees

The Parliament gets innumerable opportunities to examine and review the government administration through the institution of parliamentary debates and questions, but it does not get a chance of close and continuous examination of the detailed functioning of the executive government. Effective parliamentary control over the financial administration of the country involves scrutiny into the details of estimates and accounts, but the Parliament itself may not be a suitable organization to probe into such minute points of details, for it generally lacks the time as well as facilities for such detailed examination. For an effective parliamentary control over budgeting, it becomes essential that :

(1) the executive government obtains sanctions for expenditures in sufficient details through the instrumentality of the budget;
(2) the taxation laws and the rules and regulations regarding other receipts are laid down as explicitly and precisely as possible;
(3) the executive government must maintain records of receipts and expenditures in the form of a systematized accounting procedure so that the Parliament is able to examine and satisfy itself that the executive government have not exceeded the grants sanctioned by the Parliament, and have carried out the wishes of the Parliament as expressed by voting funds;
(4) the executive government have laid down proper rules and procedures for collection of receipts and their accounting, and for affecting expenditures of public moneys;

(5) the revenues collected and the disbursements affected conform strictly to the rules and delegation of powers laid down by the Parliament or the executive government, as the case may be;
(6) the purchases are affected and the contracts for works are awarded in conformity with the rules and procedures laid down according to the established policy; and
(7) the financial transactions of the government are conducted with wisdom, faithfulnes and economy.

The Parliament, as the representative institution of the people must, therefore, apply their mind to exercise an objective, judicious, and impartial control over the finances of the executive government. The Comptroller and Auditor General of India helps the Parliament in having an orderly administration of the executive government. The ultimate responsibility of taking due action on the comments of the Comptroller and Auditor General, however, vests with the Parliament. This responsibility has, therefore, been delegated to the Financial Committees of the Parliament which are in a position to discharge the functions properly and efficiently, while the Parliament are kept informed as to the results of the investigations, through their reports. The Parliament is thus enabled to take action thereon whenever the necessity arises. The Parliament in India, in order to exercise effective control over the financial administration of the country, have set up three Committees of the House, and they are :

(1) The Public Accounts Committee;
(2) the Estimates Committee; and
(3) the Committee on Public Undertakings.

The investigations by these Committees are carried on with a view to safeguard the public economy for : (a) scrutinizing regularity, and ensuring legality and propriety in the matters of financial administration; (b) ensuring economy; and (c) examining the financial operations of the statutory corporations and government companies. The Public Accounts Committee concerns itself primarily with (a) above; the Estimates Committee is charged with the responsibility arising out of (b); while the Committee on Public Undertakings concerns itself with matters arising out of (c). "Committees of this nature have, however, no executive power. They merely report to the House their findings and recommendations, and it is the duty of the administration to consider their propositions, to subject them in turn to careful scrutiny and to decide, upon their own responsibility, to what extent and in what way the reforms can be carried out."[1]

[1]Mukherjea, A.R , *Parliamentary Procedure in India*, Second Edition, Calcutta: Oxford University Press, 1967, p. 305.

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The Public Accounts Committee

In a parliamentary democracy, the legislature sanctions the grants for expenditure by the executive government. But mere powers to grant moneys to be expended by the executive government will not be sufficient unless the legislature has the means to ensure that the moneys sanctioned are disbursed by the executive government on specific projects for which they were sanctioned. This is ensured by Constitutional provisions providing for the appointment of an independent audit authority in order to audit the financial transactions of the executive government. In India such an authority is the Comptroller and Auditor General of India, who audits the accounts in order to ensure that moneys sanctioned by the Parliament to be expended by the executive government have actually been spent for the purpose for which they were intended by the legislature and that they have been disbursed according to law, rules and regulations. He certifies the accounts as correct, subject to whatever reservations he may decide to make, and submits his Audit Reports to the President who causes them to be laid before the Parliament.[2] Cases of waste and inefficiency, if any, are brought to the notice of the Parliament; comments are offered on important occurrences which may be of topical interest and matters having a bearing on accounting and financial principles; and cases involving heavy losses are brought into limelight. Under the audit conducted by the Comptroller and Auditor General of India, "it is no longer a question merely of satisfying oneself that vouchers exist against every expenditure, that expenditure has been incurred against due sanction, that receipts and expenditure have been properly looked and that the final accounts represent a true and fair picture of the operations of Government. More and more, Audit has become an instrument, if not the only instrument, of Parliament's control over the financial activities of the Executive."[3]

The Audit Report, alongwith the connected Appropriation Accounts, which is submitted to the President by the Comptroller and Auditor General of India, and then is submitted to the Parliament is so voluminous and technical that it should be examined by an expert body which should put up its findings to the Parliament. All the auditing labours of the Comptroller and Auditor General of India would become useless if the Parliament is not in a position to have a technical scrutiny of the Audit

[2]Article 151.

[3]Roy, A.K., Speach delivered before Northern Council of Chartered Accountants. *Chartered Accountant*, August 1963.

Reports put up by the former. For this purpose, therefore, the Parliament constitutes a special committee popularly known as Public Accounts Committee. The Public Accounts Committee examines and makes a review of the Audit Reports submitted by the Comptroller and Auditor General of India and such a review completes the cycle of parliamentary control over the finances. Shri Asok Chanda, former Comptroller and Auditor General of India observes that "the provision was made for the examination of the report by a Committee of the House, because Parliament could hardly spare the time for the necessary scrutiny in detail. It was also a technical examination which could best be undertaken in Committee. A debate in the House might also destroy the non party character of the examination and distort its proper perspective."[4]

Under the provisions of the Indian Constitution,[5] the Public Accounts Committee is constituted by both the Houses of Parliament, and is composed of 22 members, 15 members from the Lok Sabha and 7 members from the Rajya Sabha. Although the Rajya Sabha is not directly concerned with the voting of grants, it has been associated because its members are supposed to be equally concerned with the efficient administration of government finances. The members of the Committee are elected through the system of proportional representation by a single transferable vote and as such almost every party/group in the House secures representation on the Committee. "Although, theoretically, the members are elected there is hardly ever a contest in the course of an election. The selection of the members is made with great care, usually from amongst those having a financial and business background. Although the Committee is elected annually, there is a convention that there should be a two years tenure of the membership to ensure continuity. Every Committee has, therefore, a leavening of members with experience of its working."[6] The Chairman of the Committee is appointed by the Speaker from amongst the members of the Committee. Till the third Lok Sabha, the Chairman of the Committee belonged to the ruling party. In the present Lok Sabha, i.e., fourth Lok Sabha, the Chairmanship of the Public Accounts Committee has been given to the opposition, a practice which is considered democratic. "It is accepted that the Chairman of

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[4]Chanda, Asok, *Indian Administration*. London : George Allen and Unwin, 1963, p. 172.

[5]Under Article 118(1) of the Constitution, the Parliament is competent to frame rules regulating the procedure of and the conduct of business by the Public Accounts Committee known as the Legislative Rules. The rules regarding the constitution and the functions of the Public Accounts Committee are contained in the *Rules of Procedure and Conduct of Business in Lok Sabha*. New Delhi : Lok Sabha Secretariate, 1957, Rules 308 and 309.

[6]Chanda, Asok, *op.cit.*, p. 177.

the Public Accounts Committee should be chosen from among the members of the opposition parties on the Committee. Thus although the Committee will contain a majority of Government members, its proceedings will be in charge of an opposition member."[7]

The Public Accounts Committee is, without doubt, a powerful organ of the Parliament, as it is through this Committee that the Parliament completes its accountability of the executive government in the matters of finance. As regards the functions of the Public Accounts Committee, its main function is to examine the Appropriation Accounts containing the appropriation of moneys granted by the Parliament, the Annual Finance Accounts of the executive government, and such other Accounts laid before the House as the Committee may think fit.[8] While scrutinizing the Appropriation Accounts and the Audit Report thereon by the Comptroller and Auditor General, the Public Accounts Committee has to satisfy itself : *firstly*, that public moneys have been spent by the executive government as the Parliament intended to be spent; *secondly*, that due economy has been exercised in the financial transactions of the executive government; and *thirdly*, that high standards of public morality have been observed in all matters of finance.

The functions to be performed by the Public Accounts Committee are embodied in the "Rules of Procedure and Conduct of Business in Lok Sabha". In scrutinising the Appropriation Accounts and the Report of the Comptroller and Auditor General of India on the accounts, it is the duty of the Public Accounts Committee to satisfy itself :

(1) that 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;
(2) that the expenditure conforms to the authority which governs it; and
(3) that every reappropriation has been made in accordance with the provisions made in this behalf under rules framed by the campetent authority.[9]

It shall be also the duty of the Public Accounts Committee :

(1) to examine, in the light of the report of the Comptroller and Auditor General, the statement of accounts showing the income and expenditure of the state corporations, trading and manufacturing schemes, concerns and projects together with the

[7]Wheare, K.C., *Government by Committee*. London : Oxford University Press, 1955, p. 211.

[8]*The Rules of Procedure and Conduct of Business in Lok Sabha*. New Delhi : Lok Sabha Secretariat, 1957, Rule 308(1).

[9]*Ibid.*, Rule 308(2).

balance sheets and statements of profit and loss accounts which the President may have required to be prepared or are prepared under the provisions of the statutory rules regulating the financing of a particular corporation, trading or manufacturing scheme or concern or project and the report of the Comptroller and Auditor General thereon excepting such public undertakings as have been alloted to the Committee on Public Undertakings:

(2) to examine the statement of accounts showing the income and expenditure of autonomous and semi-autonomous bodies, the audit of which may be conducted by the Comptroller and Auditor General of India, either under the directions of the President or by a statute of Parliament; and

(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 or to examine the accounts of stores and stocks.[10]

The *main* function of the Public Accounts Committee is to examine the report of the Comptroller and Auditor General in order to ascertain that the moneys granted by Parliament have been spent by the executive government 'within the scope of the demands'. It demands that expenditure should not merely exceed the appropriations made without parliamentary approval,[11] but also that the nature of items of expenditure compiled against a grant should warrant their being so recorded. This examination is important to ensure that a vote of Parliament has not been avoided by the executive by adjusting expenditure in excess of a grant with another vote where saving has accrued. It also requires that a grant should have been expended only on purposes set out in details in the budget estimates and not on any new service not contemplated in the demand. The Committee is assisted in discharging this function by the Audit Reports of the Comptroller and Auditor General on Appropriation Accounts, which specify cases where : (a) grants have been exceeded; (b) budgeting is defective or control over expenditure is inadequate; *or* (c) moneys have been spent without proper sanction, either of the legislature or of the competent executive authority.

· The functions of the Committee extend 'beyond the formality of expenditure' to its wisdom, faithfulness and economy. The *second* function

[10] *Ibid.*, Rule 308(3).

[11] During the course of the financial year if any money has been spent on any service which is in excess of the amount granted by the Parliament for that purpose, the Committee examines each of such cases with reference to the facts and circumstances that lead to such an excess, and makes such recommendations as it deams fit. If considered necessary, the Committee submits a separate report on such excesses,

of the Committee is, therefore, to ensure due economy in expenditure and to draw attention to cases of waste, extravagance, losses and nugatory expenses. This function though nowhere stated in the statutory rules, has grown, by convention, to be a well established aim of the Committee. In the discharge of this duty also, the Committee looks to the Comptroller and Auditor General for bringing such cases to their notice. Whenever any case of proved negligence resulting in loss or extravagance is brought to the notice of the Committee, the Ministry/Department is called upon to report as to what action is taken and measures adopted to prevent a recurrence. In such instances, the Committee may record its opinion, *either*, disapproving the conduct of the executive authority *or* passing strictures against the extravagance or lack of control by the Ministry/ Department concerned. In fact this part of its functions has attracted far more attention in the public, press and in the Parliament than its statutory functions in relation to parliamentary appropriations.

The *third* aim of the Committee is to maintain high standards of public morality in all financial matters. "The Committee insists on the strict observance of what have come to be called in audit codes as the 'canons of financial propriety' and does not spare officers, however high in status, when it comes across doubtful practices or a falling off in the standards of public duty."[12]

The Committee is not concerned, however, with the matters of policy in the broader sense and as a rule it refrains from expressing an opinion on matters of general policy. But it is competent to point out and express an opinion whenever there has been extravagance or waste in carrying out that policy. "Since one of the functions of the Committee is to act as a check on unwise methods of expenditure, it undoubtedly possesses the power, if necessary, to intervene in the matters of administration and to examine the systems under which the Ministries work. Such intervention is, however, rare. The Committee usually concentrates on the general control to secure economy and leaves questions of internal administration to the Ministry concerned. It can nevertheless call attention to weak points in the administration itself, leaving it to the Ministry to remedy them."[13]

Powers to Call for Papers, Persons, etc.

In terms of Rule 270 of the Rules of Procedure and Conduct of Business in Lok Sabha, a Parliamentary Committee has the power to send

[12]Wattel, P.K., *Parliamentary Financial Control in India*, Second Edition. Bombay: Minerva Book Shop, 1962, p. 266.

[13]Kaul, M.N., and Shakdher, S.L., *Practice and Procedure of Parliament*. Delhi: Metropolitan Book Co., 1968, p. 662.

for persons, papers and records.[14] The Public Accounts Committee, therefore, can call for papers and send for persons to appear before it and give evidence. Usually Heads of Departments or those responsible for expenditure appear before the Committee to answer any question or criticism which it might like to ask or make. The Committee is assisted in its work by the Comptroller and Auditor General who is the 'acting hand', the guide, philosopher and friend of the Committee. He attends, by invitation, the preliminary meeting of the Committee in which the programme is decided and also every successive meeting at which witnesses are examined. Though he is not a member of the Committee and generally does not put questions, he is the right hand man of the Chairman who is generally unacquainted with the technicalities of the matters dealt with. With the permission of the Chairman, he may ask a witness to clarify a particular point and may, if he deems it necessary, make a statement on the facts of the issue.

After the examination of witnesses and internal discussions, the Committee reaches final conclusions on all the observations of the Comptroller and Auditor General. The Committee formulates its recommendations in the form of a report and the Chairman of the Committee submits it to Parliament in instalments as are ready from time to time. A summary of the minutes of the proceedings of the Committee is also included as part of the report; but the evidence is not published as in England.

Implementation of the Recommendations of the Committee

The recommendations made by the Committee are forwarded to the Ministries/Departments concerned and the latter are required to keep the Committee informed of the action taken, or proposed to be taken, by them thereon. The recommendations and observations of the Committee are treated by the executive government with respect and most of them are accepted and implemented. The administrative Ministries concerned with the various recommendations take action on them and report the matter to the Committee. If for any reason the executive government finds itself unable to accept any of the recommendations of the Committee the reasons therefor are placed before the Committee; and if the Committee is satisfied with the reasons it might modify its earlier recommendations. If there is no agreement eventually between the Committee

[14]This power is subject to the proviso that if any question arises whether the evidence of a person or the production of a document is relevant for the purposes of the Committee, the question shall be referred to the Speaker whose decision shall be final. There is a further proviso that the government may decline to produce a document on the ground that its disclosure would be prejudicial to the safety or interest of the State.

and the government, the case is referred to the Speaker.[15] So far there has been no major disagreement between the government and the Committee.

Although the Parliament can discuss the reports of the Public Accounts Committee,[16] these are seldom discussed. The Parliament rarely finds the time to discuss the reports, but opportunity is taken by the Members to refer to the reports of the Committee (and the Estimates Committee) during the discussion on Demands for Grants of the Ministries, i.e., during the budget discussion. If, however, there is a particular issue over which the Committee and the Ministry/Department concerned are at variance, that issue can be brought before the House and discussed on a motion which is not put to the vote of the House.

In addition to the Appropriation Accounts, the Finance Accounts of the government dealing with individual heads of revenue and expenditure according to Account Heads are prepared and submitted to Parliament by the Comptroller and Auditor General with his comments. These accounts are also examined by the Public Accounts Committee.

Sub-Committees and Working Groups

Whenever the Committee feels that some matter(s) involving serious financial irregularities, etc., which has/have been commented upon in the Audit Report, require(s) thorough examination, it may appoint a sub-committee to undertake such an examination. A sub-committee appointed as such and the report submitted by such a sub-committee, after the Committee approves the report, is deemed to be the report of the Public Accounts Committee.

In order to undertake an intensive study of certain matter, the Chairman of the Committee, in consultation with the members, may constitute a Working Group for the purpose. The members of the Working Group are selected having regard to, as far as possible, their known aptitudes. A convener of each Working Group is appointed by the Chairman who acts as the leader of the Group and presides over the meetings.

[15]The Public Accounts Committee is not an executive body, and has no power, even after the most minute examination and clearest evidence, to issue an order. Its reports are technically made to the Parliament and the ultimate decision on the findings rests with the latter.

[16]During an address to the Conference of the Chairmen of the Public Accounts Committees in 1959, the Speaker remarked: "Although it is open to the Legislature to discuss the reports of the Committee, a rambling discussion of the whole report leads us nowhere and tends to destroy the effectiveness of the recommendations of the Committee. I am, therefore, of the opinion that special points should be raised for discussion, more particularly those points where there is an unresolved difference of opinion between the Committee and the Government."

The nature of the control exercised by the Public Accounts Committee over the financial transactions of the executive government may thus be stated as :

(1) The control exercised by an expert body. The Public Accounts Committee usually consist of the senior members possessing considerable experience of parliamentary financial procedure.

(2) The control exercised is quasi-judicial. The recommendations of the Committee have virtually the force of law behind them and, therefore, act as a significant link between the Parliament and the executive government.

(3) Its nature is primarily that of financial control. The control exercised by the Public Accounts Committee falls mainly in the sphere of accounts and auditing and is primarily aimed at economy and efficiency.

(4) The control is non-party. The deliberations and reports of the Public Accounts Committee are not influenced usually by party considerations. It has aptly been described as a watch-dog by its intermittent barking inviting public attention to irregularities and wasteful expenditures by the executive government.

(5) The control acts as a deterrent. The control exercised by the Public Accounts Committee, though *ex post facto* does not operate merely as a post-mortem, but acts as a deterrent.

"It is to these qualities that the Public Accounts Committee owes its success. An accounts committee ought to be expert, for it deals with complicated and technical questions and discuss them with experts. It must be primarily a financial control if it is to use to the best advantage the fruits of audit. Its ability to achieve the reputation of being judicial and non-party means that it can operate with an assurance, a certainty and in effect, which bodies with political affinities cannot hope to achieve. Its inevitability with the consequent deterrent effect thereof and its achievement in securing Treasury cooperation to implement reports are probably its most valuable characteristics."[17] The effectiveness and success of the Public Accounts Committee hinges, therefore, on whether or not it can acquire these qualities.

3

The Estimates Committee

The Public Accounts Committee provides mechanism to secure accountability of the executive government in respect of moneys voted by

[17]Chubb, Basil, *The Control of Expenditure.* Oxford : The Clarendon Press, 1952, pp. 196-197.

the Parliament with a view to ensure regularity, legality, and propriety in the matters of financial administration. In order to aim at a comprehensive parliamentary control over the financial administration, however, it becomes necessary to make provisions for a detailed review of the estimates presented to legislature with a view to ensuring economy in expenditure in course of the execution of schemes and projects. The Parliament possesses the power to sanction, or to refuse to sanction, any demand for grant, or to sanction any demand subject to the reduction by the amount specified therein. It also has the power to discuss the estimates relating to the expenditure charged upon the Consolidated Fund of India.[18] Although the Parliament discusses the estimates for a fairly adequate period, it has neither the time nor the flexibility to probe into the details and the technical aspects of the estimates. In a parliamentary democracy, therefore, it is desirable that before the estimates are presented to the Parliament, they must be subjected to scrutiny by an independent financial committee of the Parliament. A need arises, therefore, for the constitution of a committee of the Parliament to examine details of estimates in a selective way, and this has led to the institution of Estimates Committee in many parliamentary democracies, including India.

In India, the first Estimates Committee was constituted in 1950 after the coming into force of the Constitution, and now is elected every year from amongst the members of the Lok Sabha only, on the basis of proportionate representation by means of single transferable vote.[19] The terms of office of the members of the Committee, who are thirty in number, is one year. The Chairman of the Committee is nominated by the Speaker, but if the Deputy Speaker happens to be a member of the Committee, he becomes the Chairman automatically. The Chairman of the Estimates Committee is, however, invariably from the members belonging to the ruling party. "The Estimates Committee, however, appears to have established a usage of choosing its Chairman from among the members of the Government party. It is possible to see a reason and perhaps a justification for the difference in practice between the two committees. As the Public Accounts Committee is looking at past, the Government is prepared to tolerate the choice of the Chairman who will not be disposed to see mistakes glossed over or whitewashed. When it comes to estimates, not yet voted, being discussed, the majority party feels safer perhaps with a Chairman of its own way of thinking."[20]

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[18] Article 113.

[19] *Rules of Procedure and Conduct of Business in Lok Sabha.* New Delhi : Lok Sabha Secretariat, 1957.

[20] Wheare, K.L., *op.cit.*, p. 211.

The Functions of the Estimates Committee

The functions of the Estimates Committee, as laid down in the 'Rules of Procedure' of the House, are :

(1) to report what economies, improvements in organisation, efficiency or administrative reform, consistent with the policy underlying the estimates, may be effected;

(2) to suggest alternative policies in order to bring about efficiency and economy in administration;

(3) to examine whether the money is well laid out within the limits of the policy implied in the estimates; and

(4) to suggest the form in which the estimates shall be presented to Parliament.[21]

In terms of the Rules of Procedure of the House, the Speaker may, from time to time, issue directions to the Chairman of the Committee, as he may deem it necessary, for regulating the procedure and organisation of the work of the Committee. The Chairman, on the other hand, may, if he thinks it proper, refer any point of procedure to the Speaker for his ruling. In pursuance of the powers of the Speaker, he has issued a number of directions from time to time aiming at regulation of the procedure of the Committee.

The Speaker by a direction has defined the amplitude of the term 'policy' referred to in (1) above. The direction states that "the term policy relates only to policies laid down by Parliament either by means of statutes or by specific resolutions passed by it from time to time." The direction provides further that "it shall be open to the Committee to examine any matter which may have been settled as a matter of policy approved by Parliament; but where it is established by evidence that a particular policy is not leading to the expected or desired results or is leading to waste, it is the duty of the Committee to bring to the notice of the House that a change in policy is called for." The then Speaker, Shri Ayyanger, inaugurating the Estimates Committee in May 1959, remarked, "your function is not to lay down any policy. Whatever policy is laid down by the Parliament, your business is to see that the policy is carried out......not independently or divorced from its financial implications. You must bear in mind constantly that you are a financial committee and you are concerned with all matters in which finances are involved. It is only where a policy involves expenditure and while going into the expenditure you find that the policy has not worked properly, you are entitled and competent to go into it. Where the policy is leading to

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[21]Rule 310.

waste, you are entitled to comment on it in a suitable way."[22] The fundamental objectives of the Committee, therefore, are economy, efficiency in administration and ensuring that money is well laid out; but, if on close examination, it is revealed that large sums are going to waste because a certain policy is followed, the Committee may point out the defects and give reasons for the change in the policy for the consideration of the House.

The Estimates Committee has also been empowered to appoint one or more sub-committees, each one of which would have the powers as that enjoyed by the main undivided Committee, to examine any issue that may be referred to them, and the report of such a sub-committee would be deemed to be the report of the whole Committee, if it is approved at a sitting of the whole Committee. This power has been used on a number of occasions.

The tenure of the Estimates Committee is one year and is, therefore, constituted annually. After formation, it makes a selection of the estimates which it would like to examine during the course of the year, notwithstanding the fact that the Committee has the power to examine all the estimates as it may decide. It is not incumbent on the Committee to examine the entire estimates of any one year. The Committee selects about three or four Ministries for a year, and reports to the House, as its examination proceeds. The guiding principle for selection is that one round of examination of the important estimates of all Ministries should, as far as possible, be completed within the life of each Lok Sabha.[23]

The Committee can also call for details regarding expenditure charged on the Consolidated Fund of India and to effect a scrutiny as to whether the classification of estimates between 'voted' and 'charged' has been effected strictly in terms of the provisions contained in the Constitution, and the Acts of Parliament. Matters of special interest which, though unconnected with particular estimates, may arise or come to light during the course of the deliberations of the Committee and if it considers that such matters should be brought to the notice of the House, they are also examined by the Committee.

After a decision is taken as to the estimates to be examined, the Committee starts collecting and collating all materials required for the due examination of the estimates in question. The Committee interviews the officials connected with the preparations of the estimates in question and take down their evidences. The Committee can issue a questionnaire under the guidance of its Chairman which the Ministry/Department

[22]Address at the inaugural sitting of the Estimates Committee, 1959-60.

[23]Speaker's address to the Conference of the Chairmen of the Estimates Committees on April 4, 1958.

concerned may be asked to answer. The Committee may call for non-official witnesses in order to ascertain their expert views on any matter of importance. Not only the Committee is empowered to send for any person but also it can call for any paper or record. Ordinarily, any paper or file which the Committee asks for, is supplied, but it does not ask for any paper or file unconnected with the enquiry in question. In certain exceptional cases, the Ministry/Department concerned may advise the Committee that certain papers or files are secret and it will not be in the public interest to disclose its contents. If it is certified by the Minister-in-charge of the Ministry/Department that the disclosure of the contents of a certain document will be against the public interest, the Committee does not enquire further and the matter ends there. But in cases where the Committee does not agree with the contention of the Ministry/Department, the matter may be referred to the Speaker for his guidance.[24]

It should be noted, however, that the particular estimates under examination of the Committee are not examined from the point of view of their justification for inclusion in the budget. Since the estimates concern the activities of the Ministry/Department and the Committee is primarily interested in the examination of these very activities, the latter scrutinizes the estimates from the following view points :

(1) Whether the methods of estimation employed are the most modern and economical.

(2) Whether the persons responsible for making such estimates possess the requisite calibre and qualifications so as to undertake such an exercise.

(3) Whether duplication, delays and defective contracts have been avoided in the course of estimation.

(4) Whether the execution of the job has been preceded by a proper and right type of consultation.

(5) Whether the scheme or the project is worth the money being spent on it.

After evidences are completed and the Committee has examined the papers and records made available by the departmental officers, the Committee considers the estimates and formulates its recommendations to the House. In case the Committee is not in full agreement with the policy reflected in the estimates, the convention is that, before the report is finalized, the Chairman of the Committee would have informal discussions with the Minister incharge of the concerned Ministry/Department. If, as a result of deliberations between the Chairman and the Minister, the

[24]So far no such eventuality has arisen as, in such cases, the Chairman of the Committee and the Minister in question resolve the difficulty after due discussion.

Committee feels that a reconsideration of its recommendations is called for, the final report is drafted in that light. Since the Committee functions on non-party basis, the recommendations are unanimous. There is no practice of putting up a note of dissent; a healthy convention which the future Committees are expected to follow. It is also a convention to show the draft report to the Speaker, before it is presented to the Parliament. The Speaker, however, simply pursues the report, but seldom refers any matter back to the Committee for reconsideration, elucidation or amplification.

The recommendations of the Estimates Committee are classified, since 1958, in an Appendix to the report, under the following categories:

(1) Recommendations for improving the organisation and working of the department.

(2) Recommendations for effecting economy alongwith an analysis of more important recommendations directed towards attainment of economy. Wherever possible, money value is also computed.

(3) General recommendations.

Before the report as adopted by the Committee is presented to the Parliament, advance copies of the same are forwarded to the Ministry/Department/Undertaking concerned and to the accredited Division of the Ministry of Finance for factual verification. This provides another opportunity to the Ministry/Department/Undertaking to support its viewpoint with any new facts or considerations. After the comments of the Ministry/Department/Undertaking are furnished to the Committee, the Chairman, if he feels it necessary, makes suitable changes in the report to correct factual inaccuracies *or* places the matter before the Committee for consideration when the facts supplied are likely to alter decisions already made by the Committee.

As a matter of convention, the reports of the Estimates Committee, like those of the Public Accounts Committee, are not discussed by the House. It is open, however, for any member of the House to refer to the reports of the Estimates Committee during the general discussion on the budget, *or*, when estimates in question are under consideration, *or*, can put up questions. Recommendations bearing important implications *or* criticism contained in the reports of the Estimates Committee can, however, be raised in the House by special motions.

Implementation of the Recommendations

"A parliamentary committee is a miniature of the House. Its recommendations reflect the general opinion of the House in as much as it is composed of members of different parties and groups representing various shades of opinion in the House. Thus, although technically the recommendations of a parliamentary committee are not formally described as directions by the House, they are in practice, regarded as such, by a long standing convention. The Government generally accepts the recomendations of the Estimates Committee and acts on them."[25] After the Committee presents the report to the House, copies of the same are forwarded to the Ministry/Department concerned and the latter are asked to submit their replies to the recommendations contained in the report not later than six months from the date of its presentation to the House. The recommendations of the Estimates Committee, in many cases, are of far reaching character. The executive government are under no obligation to accept all the recommendations of the Committee, though immense amount of respect, weight and importance is attached to the reports and recommendations of the Committee. All the recommendations are examined very carefully and the executive government ordinarily accept all of them. Inability to accept a recommendation is expressed only when inexceptionable and weighty reasons are there in doing so. Further, a recommendation may not be acceptable immediately, but, it may be implemented in due course on certain changed circumstances.

The replies alongwith other material received from the Ministries/Departments concerned are examined by a Study Group constituted for the purpose and submitted to the Chairman alongwith the recommendations of the Study Group There may be certain points which in the opinion of the Study Group and/or the Chairman require further consideration of the Committee; these points are specifically referred to the Committee.

Based on the analysis made by the Committee or the Study Gruop, a draft 'Action Taken Report' is prepared which consists of the following chapters :

(1) The Report.

(2) Recommendations and suggestions, etc., agreed to by the executive government and implemented.

(3) Recommendations where it has not been possible for the Ministry/Department to implement for reasons stated by them and which the Committee on reconsideration think should not be pressed.

(4) Recommendations which the executive government are unable to accept for reasons given by them but which the Committee feels should be implemented.

(5) Recommendations on which final replies of the executive government have not been received.

[25] Kaul, M.N., and Shakdher, S.L., *op.cit.*, p. 689.

The report after finalization is presented to the House and it is left to the House to take any further action as may be thought necessary.

4

Committee on Public Undertakings

Process of planned economic development, in which a dominant role has been assigned to the public sector, has led to a phenominal growth of public sector commercial and industrial enterprises which are either statutory corporations or companies incorporated under the Companies Act, 1956. The public sector outlays in industry and minning have been Rs. 97 crores, Rs. 1125 crores and Rs. 1959 crores during the First, Second and Third Five Year Plans respectively. The tempo was maintained by a further outlay of Rs. 588 crores in 1966-67 and Rs. 561 crores in 1967-68. The annual Plan for 1968-69 provides for a further outlay of Rs. 573 crores in industry and minning in the public sector. By March 1969, therefore, the outlay by the government in such undertakings would have crossed Rs. 4900 crores mark. A very large proportion of this outlay has come from the Union government. The funds have been made available to these undertakings from the Consolidated Fund of India after having been voted by the Parliament. Parliament has, therefore, the responsibility to ensure that these funds are properly utilized. The performance of such undertakings has, of late, become a live subject for discussions in the Parliament and as a consequence Parliament's control over the public sector undertakings has attained a particular importance. With this object in view, and taking into account the fact that both the Public Accounts Committee and the Estimates Committee were overburdened with their work, a separate Committee of the Parliament named as the Committee on Public Undertakings was constituted on May 1, 1964.[26]

As at present, the Parliament exercises control over the public undertakings in a number of ways : (a) through questions in the Parliament; (b) through debates in the House during discussions on Demands for Grants for the Ministry/Department concerned; (c) discussion specially raised on the annual reports of the public undertakings; and (d) examination by the parliamentary Committee on Public Undertakings.

The Committee consists of not more than ten members who are elected by the Lok Sabha from amongst its members according to the principle of proportional representation by means of a single transferable

[26]Prior to May 1964, a sub-committee of the Estimates Committee used to examine the working of the public undertakings.

vote.[27] Five members from Rajya Sabha, elected similarly, are associated with the Committee. The Chairman of the Committee is nominated by the Speaker from amongst the members from the Lok Sabha.

Functions

The functions of the Committee on Public Undertakings are :

"(a) to examine the reports and accounts of such public undertakings[28] as have been specifically allotted to the Committee for this purpose;[29]

(b) to examine the reports, if any, of the Comptroller and Auditor General on public undertakings;

(c) to examine, in the context of the autonomy and efficiency of public undertakings, whether the affairs of public undertakings are being managed in accordance with sound business principles and prudent commercial practices; and

(d) to exercise such other functions vested in the Public Accounts Committee and the Estimates Committee in relation to the public undertakings specified for the Committee as are not covered by clauses (a), (b) and (c) above and as may be allotted to the Committee by the Speaker from time to time.

Provided that the Committee shall not examine and investigate any of the following matters :

[27]Rule 312 B(1).

[28]A public undertaking has been defined as "an organisation endowed with a legal personality and set up by or under the provisions of a statute for undertaking on behalf of the Government of India an enterprise of industrial, commercial or financial nature or a special service organisation in public interest and possessing a large measure of administrative and financial autonomy."

[29]The public undertakings specified for the Committee are :

(1) Seven public undertakings established by special Acts of Parliament, viz., the Air India; the Central Warehousing Corporation; the Damodar Valley Corporation; the Indian Airlines Corporation; the Industrial Finance Corporation of India; the Life Insurance Corporation; and the Oil and Natural Gas Commission. Thus the jurisdiction of Committee excludes a number of statutory corporations, viz., the Agricultural Refinance Corporation; the Deposit Insurance Corporation; the Employees State Insurance Corporation; the Food Corporation of India; the Industrial Development Bank of India; the State Bank of India; the Reserve Bank of India; the Unit Trust of India; and the public corporations to be set up in future. This has been done for two reasons : not to overburden the work of the Committee and to avoid touching sensitive spots.

(2) Every government company whose annual report is placed before the House of Parliament under Section 619 of the Companies Act, 1956.

(3) Specific enterprises, viz., Bharat Electronics Ltd.; Garden Reach Workshop Ltd.; Hindustan Aeronautics Ltd.; and Mazagon Docks Ltd.

(i) matters of major government policy as distinct from business or commercial functions of the public undertakings;
(ii) matters of day-to-day administration; and
(iii) matters for the consideration of which machinery is established by a special statute under which a particular undertaking is established."[30]

The examination of the public undertakings by the Committee on Public Undertakings is, therefore, in the nature of evaluation of the performance of undertakings which covers all aspects, viz., implementation of policies, programmes, management, financial performance, etc.

Procedure in the Committee

At the beginning of each year, the Committee decides upon the subjects or the undertakings proposed to be examined during the course of the year. The Committee also selects a few subjects[31] *or* undertakings in advance for the year following the current year. In addition to a comprehensive examination of an undertaking or a subject, the Committee may also conduct a limited enquiry into the working of an undertaking which is considered to be of topical interest. In such cases, the Chairman of the Committee is authorized to ascertain full details from the undertaking concerned without prior reference to the Committee.

To start with, the Ministry/Department or Undertaking concerned with the subjects to be examined by the Committee is required to furnish preliminary material for use of the members of the Committee. Based upon the preliminary material, a memorandum and questionnaire are drafted and sent to the Ministry/Department or Undertaking for eliciting detailed information. The Committee invites also memoranda on the subjects under study from non-official organisations, viz., Chambers of Commerce, trade organisations, professional consultants, companies in the private sector, and also from private individuals. Memoranda from registered trade unions of the undertaking are also called for and examined. The views of the trade unions on matters like productivity, cost of production, avoidance of waste, measures aimed at increasing efficiency and affecting economy specifically are examined.

Officers of the undertaking are called in to appear before the Committee to tender evidence in connection with the study of the Under-

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[30]*Lok Sabha Debates*, November 20, 1963, Columns 765-766, *Third Series*.

[31]The Committee, in recent years, have made subject studies and have presented separate reports on: (a) townships and factory buildings of public undertakings; (b) management and administration of public undertakings (planning of projects); (c) material management in public undertakings; and (d) financial management in public undertakings.

taking in question. The Committee takes the evidence of the officers of the Ministry/Department in whose administrative charge the undertaking is. Deliberations with the officers of the undertakings are confined to the operational aspects of the organisation and those with the officers of the Ministry/Department cover matters of policy and such other issues for which the Ministry/Department is responsible.[32]

The Committee draws upon the Comptroller and Auditor General and his officers in pursuing such matters as have been raised in the Audit Report (Commercial) or in the Audit Reports pertaining to statutory corporations or the government company/companies under examination. The Committee obtains a 'Memorandum of Important Points' from the Comptroller and Auditor General on the issues raised in the Audit Reports. At the time of evidence tendered by the representatives of the undertaking(s) in question, the Committee is assisted by the Comptroller and Auditor General or his representative, who may, with the permission of the Chairman, ask the witness to clarify a point or make a statement on the facts of the case.

Preparation and Presentation of the Report

On completion of the examination of the subject, the Committee frames its conclusions and recommendations for inclusion in the report. Advance copies of the report as adopted by the Committee are forwarded to the undertaking and the administrative Ministry/Department and also to the accredited Division of the Ministry of Finance for factual verification of the details. Extracts from the report based on or related to the Audit paragraphs are forwarded to the Comptroller and Auditor General for factual verification.

Comments or any additional material which may have been supplied by the undertaking and/or the administrative Ministry/Department are placed before the Chairman of the Committee who makes suitable modifications in the draft report in order to correct factual inaccuracies. If the availability of additional material justifies alterations in the decisions already taken, the Chairman may place the material before the Committee for consideration.

"It will thus be clear that the presentation of reports to Parliament precedes an elaborate procedure of calling information in detail and giving an opportunity to the management to express its views during the evidence. Further, there will be a detailed discussion in the Committee

[32]The practice of inviting the officials of the undertaking(s) concerned separately from the officers of the Administrative Ministry/Department has been established in view of the autonomy normally claimed for the undertaking(s) and also to give them full freedom to put forward their view point.

at the time of finalising its report. In consequence, the importance of the examination done by the Committee on Public Undertakings is being appreciated in an increasing measure. This is natural. The reports of the Committee contain a mass of information and factual data, besides its recommendations on various points considered by the Committee. The reports are thus useful documents which assist the members of Parliament in formulating their views about the working of the undertakings."[33] The final report then is submitted to the Parliament. As a matter of convention, the report of the Committee, like those of the Public Accounts Committee and the Estimates Committee, is not discussed in the House.

Implementation of Recommendations

After the Report is submitted to the Parliament, copies of the same are forwarded to the undertaking(s) in question and the administrative Ministry/Department who are required to submit a report of the action taken within a period of six months. On receipt of such replies an 'Action Taken Report' is prepared, which is composed of the following Chapters, and submitted to the Parliament :

(1) The Report.

(2) Recommendations that have been accepted by the executive government.

(3) Replies of the executive government that have been finally accepted by the Committee.

(4) Replies of the executive government that have not been finally accepted by the Committee.

(5) Recommendations in respect of which final replies af the executive government have not been received.

The control exercised by the Committee on Public Undertakings is, however, subject to certain limitations. *Firstly*, the Committee can at the most take up for examination about ten undertakings a year. It follows that at this rate, an undertaking would come up for examination once in eight/nine years leaving the undertakings unexamined for a considerable period. *Secondly*, the examination by the Committee is such that it does not normally probe into technical matters. The members of the Committee are not usually technical experts and as such the Committee generally refrains from expressing opinion on technical matters.

[33] Tiwary, D.N., "Control by Parliament", in *The Commerce*—'A Survey on Public Sector in India". Bombay, June 22, 1968, p. 28.

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10

Finances of the Union and the State Governments

In an under developed economy, certain socio-economic objectives are set for the community to be achieved over a period of time which have got to be pursued in an intelligent, logical, coherent and coordinated fashion. The adoption of economic planning as a means towards an accelerated rate of economic growth and the launching of a series of Five Year Plans, commencing from the financial year 1951-52, marks a distinct development in the finances of the Union and State governments in India. In the scheme of planned economic development in which the public sector has been assigned a dominant role, the State has come to be charged with the vital obligation for ordered mobilization of resources and channelising the same within the framework of the objectives set out in the development Plans, influencing thereby the pattern and rate of economic growth.

The Plan document furnishes the blue-print, a sort of layout for paths of economic development during a specified period, usually a period of five years, and the government budgets provide one of the most important instrument in implementing the tasks arising out of such a blue-print. The governmental activities, which attain positive and purposive character in such a context, have consequently multiplied in a number of ways as are reflected in the trends in the budgetary performances of the Union and State governments.

Since Chinese aggression in October 1962, the budgetary policy in this country has assumed an additional dimension in strengthening the economic base, not only to support a rapid rate of economic growth with stability, but also to serve the needs arising out of the changed context of defence requirements. It is in this context that a review of the trends in the finances of the Union and State governments since 1950-51 would be undertaken in the present Chapter. The scope of such a review would be to make an assessment as to how far the budgetary performances of the Union and the State governments, for the period 1951-52 to 1968-69, have been successful towards the due achievement of the objectives set before the community.

2

Magnitude of the Union and the State Governments' Expenditures

The dominant role assigned to the public sector in initiating and maintaining the tempo of economic growth has brought about substantial changes in the character of the budgets of the Union and the State governments. This is clearly brought about by the figures shown in Table 1 below.

Table 1 : Expenditures of the Union and State Governments on Current and Capital Accounts since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Union Government's Expenditure	**425**	**571**	**1283**	**2421**	**3134**	**2878**	**2878**
(a) On Current Account[1]	354	444	877	1645	1838	1991	2117
(b) On Capital Account	71	127	406	776	1296	887	761
2. State Governments' Expenditure	**476**	**900**	**1485**	**2902**	**2993**	**3393**	**3411**
(a) On Current Account	373	604	987	1892	2194	2470	2597
(b) On Capital Account[2]	103	296	498	1010	799	923	814
3. Aggregate Expenditure(1+2)	**901**	**1471**	**2768**	**5323**	**6127**	**6271**	**6289**
4. National Income at Current Prices	**9530**	**9980**	**13274**	**20573**	**23651**	**27901**	**30090[3]**
Percentage of 1 to 4	*4.5*	*5.7*	*9.7*	*11.8*	*13.2*	*10.3*	*9.6*
Percentage of 2 to 4	*5.0*	*9.0*	*11.2*	*14.1*	*12.7*	*12.2*	*11.3*
Percentage of 3 to 4	*9.5*	*14.7*	*20.9*	*25.9*	*25.9*	*22.5*	*20.9*

[1]Total Expenditure *minus* grants-in-aid to the States.

[2]Includes loans and advances by the States.

[3]Approximately estimated.

Source : Reserve Bank of India, *Report on Currency and Finance for the Year* 1967-68. Bombay, 1968; *Reserve Bank of India Bulletin*, April 1968 and May 1968.

A study of the above table shows the following relationships between various components :

(1) Compared with an aggregate expenditure, both on current account and capital account, of Rs. 901 crores in 1950-51 (i.e., the year immediately preceding the commencement of the era of planned economic development), the aggregate expenditure of the Union and State governments increased to Rs. 1471 crores in 1955-56, i.e., by 63.2 per cent over the First Plan period. During the Second Plan period, the aggregate outlay increased further to Rs. 2768 crores in 1960-61, a growth of 88.2 per cent over that in 1955-56. During the period corresponding to the Third Plan, it rose again to Rs. 5323 crores in 1965-66, i.e., 92.3 per cent increase over the outlay in 1960-61. The three years covered by the annual Plans, viz., 1966-67, 1967-68 and 1968-69, exhibit the aggregate expenditure increasing further to Rs. 6289 crores in 1968-69, i.e., 18.1 per cent increase over that in 1965-66.

(2) The corresponding percentage increases for aggregate expenditure on 'current account' and on 'capital account' were 44.2 per cent, 77.9 per cent, 89.8 per cent and 33.3 per cent for 'current account' and 200 per cent, 113.7 per cent, 97.6 per cent and (—)11.8 per cent for 'capital account' during the First Plan, the Second Plan, the Third Plan and the three annual Plan periods respectively.

(3) An idea of the extent of the State activity in the functioning of the economy may be had by relating aggregate expenditure of the Union and the State governments, both current as well as capital, to the national income at current prices. The rotio has progressively increased from 9.5 in 1950-51 to 14.7, 20.9, 25.9 in 1955-56, 1960-61 and 1965-66 respectively, before coming down to 20.9 in 1968-69. The significance of the growing government expenditure may be appreciated from the fact that now it constitutes between one-fifth toa quarter of our national income. Viewing it from another angle, not only the national income has been increasing over the period under review, but also the government's share in that has shown a progressively rising ratio — a clear indication of the growing role of the government in our effort towards economic development.

(4) The relationship between the growth of expenditure of the Union and State governments and the growth of national income, may be visualized by constructing indices of the two variables, with data for 1950-51 as the base. The index number, for the total expenditure of the Union and State governments, standing at 100 in 1950-51, jumped to 698 in 1968-69. On the other hand, the index number for the national income, standing at 100 in 1950-51 stepped up to 316 in 1968-69. As a result, the expenditure of Union and State governments registered a much faster upward movement than the national income. In a country committed

to the establishment of a democratically constituted socialist State, the trend shown is in the right direction.

Ratio of Taxation to National Income

National income provides the capacity for resource mobilization in an economy. Table 2 below shows the percentage of tax revenues to national income for the years 1950-51, 1955-56, 1960-61, 1965-66, 1966-67 and 1967-68.

Table 2 : Tax Revenue as Percentage of National Income in India

(Rs. crores)

	1950-51 (1)	1955-56 (2)	1960-61 (3)	1965-66 (4)	1966-67 (5)	1967-68 (6)	1968-69 (7)
1. Union Tax Revenues	357	412	730	1785	1934	1946	2087
2. States' Tax Revenues	270	356	625	1118	1306	1459	1588
3. Total (1+2)	**627**	**768**	**1355**	**2903**	**3240**	**3405**	**3675**
4. National Income at Current Prices	**9530**	**9980**	**13274**	**20573**	**23651**	**27901**	**30090**[1]
Percentage of 3 to 4	*6.6*	*7.7*	*10.2*	*14.1*	*13.7*	*12.2*	*12.2*
Percentage of 1 to 4	*3.8*	*4.1*	*5.5*	*8.7*	*8.2*	*7.0*	*6.9*
Percentage of 2 to 4	*2.8*	*3.6*	*4.7*	*5.4*	*5.5*	*5.2*	*5.3*

[1]Approximately estimated.

A brief discussion of the observations on the above table is given below :

(1) It will be observed that taxation in India has mopped up an increasing proportion of national income over the successive Five Year Plans. The share of total tax revenue of the Union and the State governments in the national income which was 6.6 per cent in 1950-51 increased to 7.7 per cent, 10.2 per cent and to 14.1 per cent by the end of the First, the Second and the Third Plans respectively. The percentage stood at 13.7, 12.2 and 12.2 in 1966-67, 1967-68 and 1968-69 respectively. Both the tax revenues of the Union government and that of the State governments have mopped up the rising proportions of the national income; but the rise in the proportion of the tax revenues of the State governments to national income has been smaller and relatively slow.

(2) Whereas the percentage of the tax revenues of the Union government to national income increased from 3.8 per cent in 1950-51 to 4.1 per cent, 5.5 per cent and 8.7 per cent by the end of the First, the Second and the Third Plan periods respectively, the percentage of the tax revenues of the State governments to national income rose from 2.8 per cent in 1950-51 to 3.6 per cent, 4.7 per cent and 5.4 per cent respectively over the corresponding periods.

(3) The magnitude of the mopping-up operations, in the form of tax-revenues out of national income has been rising substantially, if the growth rate of the two aggregates are juxtaposed. The index number, for the total tax-revenues of the Union and the State governments standing at 100 in 1950-51, moved ahead to 586 in 1968-69, whereas the index number of national income, standing at 100 in 1950-51, elbowed up to 316 in 1968-69.

(4) Viewed from the proportion of the increase in tax revenues to the increase in national income, i.e., the marginal ratio of taxation to national income, it works out to be 31.3 per cent, 17.8 per cent and 21.2 per cent for the First, the Second and the Third Plan periods respectively.

3

Trends in the Revenues and the Expenditure of the Union Government

Trends in Revenues on Current Account

The revenue part of the budget of the Union government may be sub-divided into : (a) tax-revenues, and (b) non-tax revenues. The tax-revenues of the Union government include the following :

A. Taxes on income and expenditure :
(a) Taxes on income other than corporation tax;
(b) corporation tax; and
(c) expenditure tax.

B. Taxes on property and capital transactions :
(a) Estate duty;
(b) tax on wealth;
(c) gift tax;
(d) stamps and registration; and
(e) land revenue.

C. Taxes on commodities and services :
(a) Customs;
(b) Union excise duties;
(c) tax on railway passenger fares; and
(d) other taxes and duties.

The non-tax revenues of the Union government include the following:

A. Administrative receipts

B. Net contribution of public sector undertakings :
(a) Railways;
(b) posts and telegraphs;

(c) currency and mint; and

(d) others.

C. Other revenues, which include revenues from forests, opium, irrigation, electricity, road and water transport schemes and dividends due from commercial and other undertakings.

The revenues of the Union government on current account, which stood at Rs. 406 crores in 1950-51, exhibited a nominal increase of 18.5 per cent to Rs. 481 crores in 1955-56, i.e., over the period corresponding to the First Plan. Over the Second Plan period, however, the increase was of the order of 82.3 per cent, i.e., from Rs. 481 crores in 1955-56 to Rs. 877 crores in 1960-61. The period corresponding to the Third Plan was marked by two aggressions, namely, Chinese aggression in 1962 and Pakistani aggression in 1965 which resulted in an unprecedented step-up in defence expenditure. As a consequence, the step-up in the revenues of the Union government, during this period, was of the order of 164.5 per cent, i.e., from Rs. 877 crores in 1960-61 to Rs. 2320 crores in 1965-66. The revenues during the years 1966-67, 1967-68 and 1968-69, i.e., the period covered by three annual Plans, increased by 17.4 per cent, from Rs. 2320 crores in 1965-66 to Rs. 2726 crores in 1968-69. The trends in the revenues of the Union government on current account since 1950-51, with details, are shown in the Table 3 below :

Table 3 : Trends in the Resources on Revenue Account of the Union Government since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Tax Revenue	357	411	730	1785	1934	1946	2087
of which :							
Income-tax[1]	85	76	80	148	172	126	163
Corporation tax	40	37	111	305	329	320	320
Customs	157	167	170	539	585	523	539
Union excise[1]	68	129	341	752	803	929	1012
2. Non-tax Revenue	49	70	147	535	539	599	639
of which :							
Net contribution of public enterprises	23	29	53	79	87	102	107
3. Total Receipts on Revenue Account (1+2)	**406**	**481**	**877**	**2320**	**2473**	**2545**	**2726**

[1]Net of the share attributable to the States.

Source : Reserve Bank of India, *Report on the Currency and Finance for the Year 1967-68.* Bombay, 1968; *Reserve Bank of India Bulletin,* April 1968.

Another notable feature of the trends in the revenues of the Union government has been an increasing importance of indirect taxes vis-a-vis direct taxes. In 1950-51, income tax and corporation tax put together constituted 35 per cent of the total tax revenues. The ratio has shown a progressive decline to 27.5 per cent in 1955-56, 26.2 per cent in 1960-61, 25.4 per cent in 1965-66, and finally to 23.1 per cent in 1968-69. On the other hand, the customs duties and Union excise duties which accounted for 63 per cent of the aggregate tax revenue in 1950-51, showed an increase to 72 per cent, 70 per cent, 72.3 per cent and 74.1 per cent in 1955-56, 1960-61, 1965-66 and 1968-69 respectively. The trend shows that for the Union government, the reliance on indirect taxes as the chief mobiliser of revenues has progressively been increasing since the start of planned economic development.

The progress of tax revenues of the Union government since 1950-51, as shown in the Table 3 above, indicates that these revenues are primarily derived from four sources: (a) income-tax; (b) corporation tax; (c) customs duties; and (d) central excise duties. These four sources, among themselves, continue to contribute more than 97 per cent of the total tax revenue of the Union government.

As regards income tax, including the corporation tax, the collection showed a declining trend upto 1955-56, mainly because of the post-Korean War recessionary trends, but once the tempo of economic development picked up the trend has shown a progressively rising collections from this source.

The revenue from customs duties was Rs. 157 crores in 1950-51, which increased nominally to Rs. 167 crores in 1955-56, and to Rs. 170 crores in 1960-61. While revenues from all other major taxes showed a progressively increasing trend, the trend in customs revenue was just a nominal increase. This was due to the following main causes: (a) reduction in the country's share in the international trade; (b) import of capital goods and essential raw materials, which constituted a bulk of our imports, were either allowed to be imported free of duty or were subjected to very low rate of duty; (c) as an effort towards export promotion, very few export items were subjected to export duties. The collections from customs have, however, shown an increasing trend since 1960-61 and the receipts were put at Rs. 539 crores, Rs. 585 crores, Rs. 523 crores, and Rs. 539 crores in the years 1965-66, 1966-67, 1967-68 and 1968-69 respectively.

The most striking feature of the tax revenues of the Union government is the phenominal rise in the revenues from the central excise duties *net* of the devolution of States' share. From Rs. 68 crores in 1950-51 the proceeds have grown to Rs. 129 crores in 1955-56, Rs. 341 crores in 1960-61, Rs. 752 crores in 1965-66, and Rs. 1012 crores in 1968-69. The growth reflects, to a large extent : (a) growth of industrial production; (b) diversification of industrial production; and (c) increase in the rates. With the advancement and diversification of the structure of the economy, Union excise duties are bound to remain as the most important singlee sourc of revenue to the Union government.

Trends in Expenditure on Current Account

The trends in the revenue expenditure of the Union government since 1950-51 alongwith details according to major heads are shown in the Table 4 below. The total revenue expenditure has grown from Rs. 354 crores in 1950-51 to Rs. 2117 crores in the year 1968-69, about six-fold increase over the period.

Table 4 : Trends in the Revenue Expenditure of the Union Government since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Defence (net)	164	172	248	762	798	857	894
2. Civil	190	272	629	883	1040	1134	1223
of which :							
(a) Civil administration	21	34	59	95	123	137	140
(b) Interest payments	37	43	77	371	463	508	550
(c) Social and development services	40	82	236	275	233	272	298
3. Total Expenditure on Revenue Account (1+2)	**354**	**444**	**877**	**1645**	**1838**	**1991**	**2117**
Percentage of 1 to 3	46.3	38.7	28.3	46.3	43.4	43.0	42.2
Percentage of 2 to 3	53.7	61.3	71.7	53.7	56.6	57.0	57.8
Percentage of 2(a) to 3	11.1	15.8	9.4	10.8	11.8	12.1	11.4
Percentage of 2(b) to 2	19.5	15.8	12.2	42.0	44.5	44.8	45.0

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68*. Bombay, 1968; *Reserve Bank of India Bulletin* April 1968.

The defence expenditure on revenue account which was Rs. 164 crores in 1950-51 had a steady increase to Rs. 248 crores in 1960-61, an increase of 51.2 per cent over a period of ten years. Then came the Chinese aggression in October 1962 and Pakistani aggression in September 1965, and as a consequence the defence expenditure on revenue account increased to Rs. 762 crores, Rs. 798 crores, Rs. 857 crores and Rs. 894 crores in 1965-66, 1966-67, 1967-68 and 1968-69 respectively. Viewed from another angle, defence expenditure on revenue account in 1950-51 accounted for 46.3 per cent of the total expenditure on revenue account of the Union government. The proportion declined to 38.7 in 1955-56 and further to 28.3 in 1960-61. It shot up to 46.3 in 1965-66 and since then the ratio is again on the decline.

Interest on debt has increased by a little less than fifteen-fold, from Rs. 37 crores in 1950-51 to Rs. 550 crores in 1968-69, reflecting thereby the fast growing debt burden of the Union government. Interest payments as ratio of aggregate civil expenditure constituted 19.5 per cent in 1950-51. The ratio declined to 15.8 per cent in 1955-56 and to 12.2 per cent in 1960-61. Since then it has shown a progressive increase to 42.0 per cent in 1965-66 and further to 45.0 per cent in 1968-69.

Capital expenditure on revenue account has increased seven-fold, from Rs. 40 crores in 1950-51 to Rs. 298 crores in 1968-69, a trend in the right direction in a developing economy.

Trends in the Union Government's Receipts and Disbursements on Capital Account

The trends in the receipts of the Government of India on capital account are shown in the Table 5 on page 215. Over the First Plan period, total receipts on capital account increased from Rs. 104 crores in 1950-51 to Rs. 281 crores in 1955-56, an increase of 170.1 per cent. Over the Second Plan period, they increased from Rs. 281 crores in 1955-56 to Rs. 1127 crores in 1960-61, i.e., an increase of 300.4 per cent. The period corresponding to the Third Plan was marked by a further increase of 42.7 per cent from Rs. 1127 crores in 1960-61 to Rs. 1608 crores in 1965-66. The step-up during the period covered by the three annual Plans, i.e., 1966-67, 1967-68 and 1968-69, was of the order of 22.9 per cent, from Rs. 1608 crores in 1965-66 to Rs. 1977 crores in 1968-69.

Market borrowings (gross) which constituted 36.5 per cent of the total receipts on capital account of the Union government had a progressive increase in 38.1 per cent in 1955-56, 39.6 per cent in 1960-61, 52.3 per cent in 1965-66, and 66.7 per cent in 1968-69. The relative contribution of external borrowings (gross) to the total market borrowings (gross) makes an interesting reading. External loans accounted for 21.1 per cent in 1950-51. The ratio increased to 59.4 per cent and 66.8 per cent by the end of the Second and Third Plans respectively. This ratio increased further to 75.9, 74.4 and 77.3 per cent in 1966-67, 1967-68 and 1968-69 respectively. This clearly confirms that with the successive Five Year Plans, the Union government's dependence on external borrowing for financing its development expenditure has increased progressively.

Table 5 : Trends in the Union Government's Receipts on Capital Account since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Market Borrowings (gross)	38	107	446	841	1141	1365	1319
(a) Internal (gross)	*30*	*104*	*181*	*279*	*275*	*350*	*300*
(b) Internal (net)	*(—)12*	*35*	*72*	*124*	*93*	*93*	*61*
(c) External (gross)	*8*	*3*	*265*	*562*	*866*	*1015*	*1019*
(d) External (net)	*4*	—	*247*	*481*	*704*	*830*	*825*
2. Small Savings (net)	34	67	104	151	118	110	120
3. Repayment of Loans by the States	8	25	95	276	281	385	425
4. Others	24	82	482	340	796	376	113
5. Total Receipts on Capital Account[1] (1 to 4)	**104**	**281**	**1127**	**1608**	**2336**	**2236**	**1977**
Percentage of 1 to 5	*36.5*	*38.1*	*39.6*	*52.3*	*48.8*	*61.0*	*66.7*
Percentage of 2 to 5	*32.7*	*23.8*	*9.2*	*9.3*	*5.1*	*4.9*	*6.1*
Percentage of 1(a) to 1	*78.9*	*97.2*	*40.6*	*33.2*	*24.1*	*25.6*	*22.7*
Percentage of 1(c) to 1	*21.1*	*2.8*	*59.4*	*66.8*	*75.9*	*74.4*	*77.3*

[1]Excluding Treasury Bills

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay, 1968; *Reserve Bank of India Bulletin,* April 1968.

Small savings contributed 32.7 per cent of the total receipts on capital account of the Union government in 1950-51. The ratio declined to 23.8 per cent in 1955-56 and further to 9.2 and 9.3 per cent in 1960-61 and 1965-66. The corresponding ratios for 1966-67, 1967-68 and 1968-69 were 5.1, 4.9 and 6.1 per cent respectively. It shows that in the efforts aimed at resource mobilization on the part of the Union government, the importance of small savings, of late, has been reduced to insignificance.

The details of the disbursements on capital account by the Union government since 1950-51 are given in the Table 6 on page 216.

Table 6 : Trends in the Union Government's Disbursements on Capital Account since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Capital Outlay	71	127	406	776	1296	887	761
of which :							
Defence	*4*	*18*	*33*	*123*	*111*	*113*	*121*
2. Loans and Advances to the States (gross)	61	241	339	829	931	885	856
(net)	*53*	*216*	*244*	*553*	*650*	*500*	*431*
3. Other Loans (net)	4	24	128	274	339	385	337
4. Discharge of Permanent Debt	46	72	127	236	344	442	433
(a) internal	*42*	*69*	*109*	*155*	*182*	*257*	*239*
(b) external	*4*	*3*	*18*	*81*	*162*	*185*	*194*
5. Others	1	7	1	10	13	19	2
6. **Total Disbursements on Capital Account (1 to 5)**	**183**	**471**	**1001**	**2125**	**2923**	**2618**	**2389**

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay, 1968; *Reserve Bank of India Bulletin,* April 1968.

4

Finances of the State Governments

Trends in the Revenues on Current Account

The tax revenues of the State governments include the following :

A. Taxes on income:

(a) States' share of income tax;

(b) agricultural income tax; and

(c) profession tax.

B. Taxes on property and capital transactions :

(a) Estate duty;

(b) land revenues;

(c) stamps and registeration; and
(d) urban immovable property tax.

C. Taxes on commodities and services:
(a) States' share of Union excise;
(b) State excise;
(c) general sales tax;
(d) sales tax on motor spirit;
(e) motor vehicles tax;
(f) tax on railway fares;
(g) entertainment tax;
(h) electricity duties; and
(i) other taxes and duties.

The non-tax revenues of the State governments include the following:

A. Administrative receipts

B. Net contribution of the public sector undertakings:
(a) Forests;
(b) irrigation;
(c) electricity schemes;
(d) road and water transport; and
(e) industries and others.

C. Other revenues

D. Grants-in-aid and other contributions

The revenues of the State governments on current account, which stood at Rs. 368 crores in 1950-51 exhibited an increase of 50.6 per cent to Rs. 554 crores in 1955-56, i.e., over the period corresponding to the First Plan. Over the Second Plan period, however, the increase was of the order of 82.7 per cent, i.e., from Rs. 554 crores in 1955-56 to Rs. 1012 crores in 1960-61. The period corresponding to the Third Plan exhibited a further step-up in the revenues of the States from Rs. 1012 crores in 1960-61 to Rs. 1850 crores in 1965-66, an increase of 81.8 per cent. The revenues during the years 1966-67, 1967-68 and 1968-69, i.e., the period corresponding to the three annual Plans, increased by 40.8 per cent, from Rs. 1850 crores in 1965-66 to Rs. 2605 crores in 1968-69.

The share of tax-revenues in the total revenue receipts of the State governments constituted 73.4 per cent in 1950-51. The percentage share declined to 64.3 in 1955-56, to 61.8 in 1960-61 and further to 60.4 in 1965-66. The ratio was 61.0 in 1968-69. Another significant development has been that whereas the ratio of 'own-resources in tax revenue' to total tax revenue was 80.7, 79.2 and 80.3 per cent in 1950-51, 1955-56 and 1960-61 respectively, it declined to 75.3 and 73.7 in 1965-66 and 1968-69 respectively. This shows that the increase in the tax revenues of the

States on their own effort has been slower than the increase in the share in the Union taxes. The States' increasing dependence on Centrally raised revenues is also highlighted by the contribution of Union grants-in-aid to the non-tax revenues of the States. In 1950-51 Union grants-in-aid of the revenues of the States accounted for 8.2 per cent of the non-tax revenues of the States. The percentage increased to 26.8 in 1955-56, to 31.5 in 1960-61 and further to 44.9 in 1965-66. In 1968-69, it stood at 44.8.

Table 7 : Trends in the Resources of the State Governments on Revenue Account since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Tax revenue	270	356	625	1118	1306	1459	1588
(a) share from the Union	*52*	*74*	*169*	*276*	*368*	*408*	*418*
(b) own resources	*218*	*282*	*456*	*842*	*938*	*1051*	*1170*
2. Non-tax revenue	98	198	387	732	829	983	1016
(a) grants from the Union	*8*	*53*	*122*	*329*	*397*	*453*	*455*
(b) administrative receipts	*90*	*62*	*140*	*145*	*164*	*174*	*181*
(c) net contribution of public enterprises	*	*31*	*48*	*60*	*64*	*75*	*86*
(d) others	*	*52*	*77*	*198*	*204*	*281*	*294*
3. Total Revenue Receipts	**368**	**554**	**1012**	**1850**	**2135**	**2442**	**2604**
Percentage of 1 to 3	*73.4*	*64.3*	*61.8*	*60.4*	*61.2*	*59.7*	*61.0*
Percentage of 1(b) to	*180.7*	*79.2*	*80.3*	*75.3*	*71.8*	*72.0*	*73.7*
Percentage of 2(a) to 2	*8.2*	*26.8*	*31.5*	*44.9*	*47.9*	*46.1*	*44.8*
Percentage of 1(a)+2(a) to 3	*16.3*	*22.9*	*28.8*	*32.7*	*35.8*	*35.3*	*33.5*

*Rs. 90 crores, shown under administrative receipts include net contribution of public enterprises and others as details are not available.

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay, 1968; *Reserve Bank of India Bulletin,* May 1968.

The importance of Centrally transferred resources, viz., tax-share from the Union plus Union grants-in-aid, in the total revenue receipts of the State governments has progressively increased since 1950-51. In the year 1950-51, Centrally transferred resources constituted 16.3 per cent of the total revenue receipts of the State governments. The ratio increased to 22.9 in 1955-56, 28.8 in 1960-61 and further to 32.7 in 1965-66. The ratio stood at 33.5 in 1968-69. Table 7 above shows the details.

Trends in Expenditure on Current Account

The trends in the expenditure of the State governments on revenue account since 1950-51 are shown in the Table 8 below. The total revenue expenditure of the State governments has grown from Rs. 373 crores in 1950-51 to Rs. 2597 crores in 1968-69, about seven-fold increase over the period.

Table 8 : Trends in Expenditure on Revenue Account of the State Governments since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Development expenditure	184	338	570	1103	1213	1367	1460
2. Non-development expenditure	189	266	417	789	981	1103	1137
of which :							
(a) Debt services	7	19	84	269	356	400	455
(b) Civil administration	104	122	167	273	295	321	358
3. Total expenditure (1+2)	**373**	**604**	**987**	**1892**	**2194**	**2470**	**2597**
Percentage of 1 to 3	49.3	56.0	57.7	58.3	55.3	55.3	56.2
Percentage of 2 to 3	50.7	44.0	42.3	41.7	44.7	44.7	43.8
Pescentage of 2(a) to 2	3.7	7.1	20.1	34.1	36.3	36.3	40.0
Percentage of 2(b) to 2	55.0	45.9	40.0	34.6	30.1	29.1	31.5

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay, 1968; *Reserve Bank of India Bulletin,* May 1968.

Development expenditure on revenue account constituted 49.3 per cent of the total expenditure on revenue account in 1950-51. It increased to 56.0 per cent in 1955-56, to 57.7 per cent in 1960-61, and further to 58.3 per cent in 1965-66. The ratio stood at 56.2 per cent in 1968-69. With bulk of the development services falling within the sphere of States, the trend has been in the right direction. Relative importance of non-development expenditure has correspondingly been declining.

Expenditure on debt services which formed 3.7 per cent of non-development expenditure in 1950-51 increased to 7.1 per cent in 1955-56, 20.1 per cent in 1960-61, and further to 34.1 per cent in 1965-66. The percentage increased further to 40.0 in 1968-69 reflecting thereby a progressively growing burden of debt services in the finances of the State governments. Expenditure on civil administration which constituted 55.0 per cent of the non-development expenditure declined, however, to 45.9 per cent in 1955-56, to 40.0 per cent in 1960-61 and 34.6 per cent 1965-66. It was 31.5 per cent in 1968-69; a trend in the proper direction.

Trends in the State Governments' Receipts and Disbursements on Capital Account

The trends in the receipts of the State governments on capital account are given in the Table 9 below. Over the First Plan period the total receipts on capital account increased from Rs. 128 crores in 1950-51 to Rs. 382 crores in 1955-56, an increase of 198.8 per cent. Over the Second Plan period, they increased from Rs. 382 crores in 1955-56 to Rs. 580 crores in 1960-61, i.e., an increase of 51.8 per cent. The period corresponding to the Third Plan was marked by a further increase of 125.7 per cent from Rs. 580 crores in 1960-61 to Rs. 1309 crores in 1965-66. The receipts in 1966-67 and 1968-69 were marginally less and those in 1967-68 were more than in 1965-66.

Table 9 : Trends in the State Governments' Receipts on Capital Account since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 Accounts)*	*1966-67 (Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Permanent Debt	8	74	94	107	94	127	113
2. Loans and Advances	120	308	486	1202	1130	1201	1171
of which :							
(a) Loans from the Union	*N/A*	*262*	*346*	*816*	*918*	*829*	*714*
(b) Repayment of Loans to States	*N/A*	*27*	*49*	*95*	*111*	*163*	*193*
3. Total Receipts on Capital Account	**128**	**382**	**580**	**1309**	**1224**	**1328**	**1284**
Percentage of 2(a) to 3	—	*68.5*	*59.7*	*62.3*	*75.0*	*62.4*	*55.6*

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay, 1968; *Reserve Bank of India Bulletin,* May 1968.

Another notable feature of the progress of the State governments' receipts on capital account is a large dependence on the loans from the Union government. Excepting the year 1968-69, such dependence has been between three-fifth to three-fourth.

The details of the disbursements on capital account by the State governments since 1950-51 are given in the Table 10 below :

Table 10 : Trends in the State Governments' Disbursements on Capital Account since 1950-51

(Rs. crores)

	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Accounts)*	*1967-68 (Revised)*	*1968-69 (Budget)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Capital Outlay	70	199	318	491	358	466	442
(a) Development	*83*	*206*	*294*	*404*	*422*	*433*	*432*
(b) Non-Development	(—)*13*	(—)*7*	*24*	*87*	(—)*64*	*33*	*10*
2. Loans and Advances by the States	33	97	180	520	441	457	372
3. Repayment of Loans and Advances	3	25	117	304	336	429	494
4. Discharge of Permanent Debt	8	15	18	9	10	60	68
5. Total Disbursements on Capital Account	**114**	**336**	**633**	**1324**	**1145**	**1412**	**1376**

Source : Reserve Bank of India, *Report on the Currency and Finance for the Year 1967-68.* Bombay, 1968; *Reserve Bank of India Bulletin,* May 1968.

11

Trends in and Structure of Public Debt

Introduction

It is now widely recognised that for rapid and coordinated development of emergent economies the State has to assume much broader obligations and to undertake responsibility for providing an extensive 'infra structure' through the development of transport and communications, major and medium irrigation, power, etc., and also to build up basic industries. In under-developed countries, therefore, the State's responsibilities in economic and social spheres are naturally far greater than those in advanced countries. Here the State has to undertake all kinds of developmental programmes which, for various reasons, are either unsuitable for private enterprise *or* beyond the latter's capacity *or* are to be undertaken by the State to serve some socio-economic objectives. It has also to develop social services to keep in step with the growth of economic activity and the growing expectations of the people, particularly in a parliamentary democracy.

Financing of all these schemes[1] requires large resources which it is

[1]Since the initiation of planned economic development in India, the Plan outlays in the public sector have progressively increased with every successive Five Year Plan. It aggregated to Rs. 1960 crores in the First Plan, Rs. 4672 crores in the Second Plan, and Rs. 8630 crores in the Third Plan periods. The total for the three Plan periods was thus of the order of Rs. 15262 crores. The development expenditure in 1966-67, 1967-68 and 1968-69 was of the order of Rs. 2141 crores, Rs. 2290 crores and Rs. 2337 crores respectively.

impossible to secure from taxation alone. The government must borrow, therefore, on a vast scale in order to supplement its resources with a view to discharge its extended obligations effectively. Increase in public debt need not cause concern so long as it is accompanied by the growth of productive assets and increase in the productivity of the economy, and so long as borrowings came from the genuine savings of the community. It is, therefore, not so much the size of the debt as the manner and method of borrowing and the utilisation of borrowed money that are of crucial importance.

2

Rationale of Public Borrowing in a Developing Economy

Taxation constitutes a method of forced savings. Public borrowing is a device which can be used to mobilize a substantial part of the voluntary savings of the community in order to finance the development Plan of the public sector. Public borrowing as a means towards resource mobilization for economic development has, therefore, an advantage over taxation. Taxation, when carried too far, may have adverse effects on economic incentives. Public borrowing, on the other hand, involves the mobilization of resources which may not have that adverse effect on incentives, *firstly*, because of its voluntary nature, and, *secondly*, because of the expectations of repayment.

Commenting upon the relative share of taxation and public borrowing in the fiscal structure of an underdeveloped economy, a U.N. report observes that "taxation should cover at least current expenditure on normal government services. Borrowing is particularly appropriate to finance government expenditure which results in the creation of capital assets or which is otherwise directly productive."[2] If the public authorities in the developing economies follow this policy on financing economic development from public borrowing, *or* rather finance a part of the development expenditure from revenue surpluses[3] and the other part from borrowing, a growing public debt would not necessarily be a burden on the economy, provided that the capital assets thus created and additional productive

[2]United Nations, *Domestic Financing of Economic Development*. New York, 1950, p. 8.

[3]Probably, in a developing economy, there may not be much choice between taxation and public borrowing as means of resource mobilization to finance development Plans. In view of the magnitude of the problem of resource mobilization all possible resources are required to be tapped to the maximum extent possible in order to meet the demands arising out of developmental effort.

capacity are productively and efficiently used contributing thereby to the growth of national income. In an underdeveloped economy, therefore, the public borrowing and the resultant public debt, if skillfully and prudently managed, becomes an important instrument of economic development.

Apart from being used as an instrument of resource mobilization for financing economic development, a growing public debt has certain other distinct advantages. To the extent it mobilizes savings which would otherwise have been utilised as hoards, for investment in non-productive real estate, purchase of bullion, ostentatious residential construction, or for speculative purposes, the funds thus raised become a positive factor contributing towards an accelerated rate of economic development. A systematic and carefully planned policy of public borrowing may not only reduce the interest burden of public debt but may act as the most desirable instrument in channeling the flow of resources in the right directions.

The formulation of a monetary policy aimed at the achievement of economic objectives socially determined is intricately related to the growth, volume and structure of public debt. Money and capital markets in underdeveloped economies are ordinarily unorganised and underdeveloped. A growing public debt in these circumstances, therefore, provide the monetary authorities with assets which they can base upon for formulating a developmental monetary policy suited to serve the needs of economic development in these countries.

The public authorities in underdeveloped countries may make use of two important methods of public borrowing : (1) by floating negotiable government securities and bills/bonds which are traded in the capital and money markets and for which market quotations are given; and (2) public borrowing of a non-negotiable character.

Problems of Public Borrowing in Underdeveloped Countries

Public borrowing as a device for mobilization of the savings of the community in an underdeveloped economy is faced with some special problems.

Firstly, in many underdeveloped economies there are no organised capital and money markets. In the countries where such markets exist, they are narrow and thin in relation to the resource needs of a developing economy in as much as they are inadequate even to serve the needs of a small organized private industrial sector. In this context, if the public authorities enter the market with a substantial borrowing programme it may well have unsettling effects on the smooth functioning of such markets.

Secondly, one of the characteristics of an underdeveloped economy is that a major portion of national income originates from agriculture and allied activities, i.e., rural sector. The savings originating in this sector are incapable of being mobilized through taxation because of the relatively inadequate monetization of this sector. Mobilization of such savings on a substantial scale through public borrowing would, therefore, be dependent primarily, on the development and extension of organised financial institutions in the rural sector, a factor which is generally absent in the underdeveloped economies.

Thirdly, the problem of public borrowing as a means of resource mobilization in an underdeveloped economy has two aspects : (a) the problem of finding out the propensities to save of the different strata of population classified by income groups and further into convenient sub-sectors such as rural and urban; and (b) the detailed examination of the constituents (and their relative propensities) of the money and capital markets which comprise together the financial system of the country. Such institutional studies would normally be faced with a number of difficulties in an underdeveloped economy.

Fourthly, in the rural sector, mostly the savers are the substantial farmers or the money lenders. They do lend their surpluses but at exhorbitant rates of interest and for consumption purposes mostly. The volume of their lending activity and the rates of interest charged by them have an important bearing on the efforts at mobilization of domestic resources. A structure of very high rates of interest militates against the investment of savings owned by the people in the rural sector in the projects of long-term productive potentialities where the rate of return is invariably low. Thus, "so long as the competition of such high returns exists, there can be little hope of attracting increased funds into agricultural improvement, savings accounts, government bonds, small scale industry or other channels of investment."[4]

Fifthly, in the predominantly agrarian economies, investment in land is the major factor. Another major element is the investment in precious metals. A pattern of investment in land, subsistence commodities and precious metals not only yields a relatively high return to the landowner lender, but also satisfies the liquidity preference and safety preference in such a society.[5]

Sixthly, the prevalence of high rates of interest in the underdeveloped economies exercises a depressing effect on the private investment. In the investment programmes where the gestation periods are relatively longer, i.e., the interval between the point of investment and the point of earning

[4]United Nations, Economic Commission for Asia and Far East, *Mobilization of Domestic Capital in Certain Countries of Asia and Far East.* Bangkok, 1951, p. 81.

[5]George Rosen, "Capital Market and the Industrialization of Underdeveloped Economies", *Indian Economic Journal,* October 1958, p. 178.

normal profits is considerable, a high rate of interest involves a substantial burden on the enterprises and that acts as a powerful factor for discouraging investment.

Techniques of Public Borrowing

The techniques to be applied for public borrowing depend primarily on the stage of the development of money and capital markets in the economy in question and the structure of its economic and financial organization. In order to mobilize a substantial amount of resources through public borrowing, the denominations of various kinds of securities floated, the rates of interest paid on them, and their relative maturities must suit the preferences of the different categories of investors. Securities meant for institutional investors are generally of large denominations whereas the securities meant for the public is of low denominations. A relatively high rate of interest is generally offered to the public on special securities meant for them whereas a lower rate of interest is offered on market borrowings.

Public Borrowing and Financial Institutions

The financial machinery in the underdeveloped countries is capable of improvement in a number of directions, and the striving for such improvement should be a part of all policies directed towards development. The financial institutions of underdeveloped countries share in the state of general economic development; added to the general weakness and insufficiency there is a specific weakness in financial provision for the productive investments and improvements which form the essence of economic development.[6] The development and growth of financial structure of an economy, therefore, is one of the most important pre-requisites of effective mobilization of resources in underdeveloped economies.

3

Loan Finance in the Five Year Plans

In the financing of Plan outlays in the public sector since 1951-52, the borrowings have played an important role. The government have depended primarily on four principal forms of borrowing : (a) market borrowing through the issuance of dated rupee loans; (b) small savings through the sale of various debt certificates of different maturities and the post office saving accounts; (c) unfunded debt of various kinds which

[6]*Mobilization of Domestic Capital in Certain Countries of Asia and Far East*, op.cit., p. 81.

are contractual in nature; and (d) borrowings from the Reserve Bank of India through the issuance of ad-hoc treasury bills. The issue of ad-hoc treasury bills are in addition to the regular auctions of treasury bills to the public. The financing pattern of Plan outlays since 1951-52 is given in the Table 1 below :

Table 1 : Financing Pattern of Plan Outlays in the Public Sector since 1951-52

(Rs. crores)

	First Five Year Plan 1951-52 to 1955-56	*Second Five Year Plan 1956-57 to 1960-61*	*Third Five Year Plan 1961-62 to 1965-66*	Annual Plans *1966-67*	*1967-68*	*1968-69*
	(1)	(2)	(3)	(4)	(5)	(6)
A. Budgetary and other own resources	**752** *(38.4)*	**1230** *(26.3)*	**2885** *(33.4)*	**510** *(23.8)*	**364** *(16.5)*	**745** *(31.9)*
B. Domestic borrowings	**1019** *(52.0)*	**2393** *(51.2)*	**3290** *(38.1)*	**839** *(39.3)*	**850** *(38.6)*	**716** *(30.6)*
1. Market Borrowings[1]	204	756	915	204	200	158
2. Small Savings	243	422	585	120	109	115
3. Unfunded debt and other capital receipts	239	261	640	326	182	136
4. Deficit financing[2]	333	954	1150	189	359	307
C. Total domestic resources (A+B)	**1771** *(90.4)*	**3623** *(77.5)*	**6175** *(71.5)*	**1349** *(63.1)*	**1214** *(55.1)*	**1461** *(62.5)*
D. External assistance[3]	**189** *(9.6)*	**1049** *(22.5)*	**2455** *(28.5)*	**788** *(36.9)*	**991** *(44.9)*	**876** *(37.5)*
E. Total Resources (C+D)	**1960** *(100.0)*	**4672** *(100.0)*	**8630** *(100.0)*	**2137** *(100.0)*	**2205** *(100.0)*	**2337** *(100.0)*

[1]Figures for the First and Second Plan periods represent market borrowings while for the subsequent Plan periods, represent net obsorption of loans and treasury bills by the public, i.e., investors other than the Reserve Bank of India.

[2]Figures of deficit financing shown for the Third Plan period and the subsequent years refer to changes in government indebtedness (both long-term and short-term) to the Reserve Bank of India. These are, therefore, not comparable with those for the first two Plans which relate to budget deficits. On a comparable basis, deficit financing during First and Second Plan periods works out to be Rs. 260 crores and Rs. 1170 crores respectively.

[3]Figures in columns 4 to 6 are at the new rates of exchange and consequently, these are not comparable with the figures of the earlier Plan periods.

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay, 1968.

It will be observed that the budgetary and other own resources, representing balance from current revenues and surpluses of public enterprises contributed 38.4 per cent of the total resources during the First Plan period. The ratio declined to 26.3 per cent in the Second Plan period and then increased to 33.4 per cent during the Third Plan period. The percentages for the years 1966-67, 1967-68 and 1968-69 (i.e., the period corresponding to the three annual Plans) were 23.8, 16.5 and 31.9 respectively.

The share of domestic borrowings in the total resources during the First and Second Plan periods amounted to 52.0 per cent and 51.2 per cent respectively. The ratio declined to 38.1 per cent in the Third Plan period. The ratios for the years 1966-67, 1967-68 and 1968-69 were 39.3, 38.6 and 30.6 respectively. It means that whereas domestic borrowings, including deficit financing, contributed more than a half of the total Plan outlays during the First and the Second Five Year plans, the contribution would have been less than one third in 1968-69.

In the resources raised from domestic borrowings, deficit financing accounted for 32.7 per cent in the First Plan period. The ratio for the Second Plan period was 39.9 per cent while it was 35.0 per cent for the Third Plan period. Deficit financing contributed 22.5 per cent, 42.2 per cent and 42.9 per cent of the domestic borrowings during 1966-67, 1967-68 and 1968-69 respectively.

Total domestic resources, i.e., budgetary and other own resources *plus* domestic borrowings, contributed 90.4 per cent of the total Plan outlays during the First Plan period, the balance of 9.6 per cent having been accounted for by external assistance. The respective ratios were 77.5 and 22.5 during the Second Plan and 71.5 and 28.5 for the Third Plan period. The declining ratio attributable to total domestic resources and a correspondingly rising ratio of external assistance indicate our growing dependence on external assistance for financing development Plans. The contributions from external assistance became still more significant during the years 1966-67, 1967-68 and 1968-69 touching a record percentage of 44.9 in 1967-68.

The structure of Plan outlays in the public sector since 1951-52 is given in the Table 2 on page 229.

Table 2 : Outlay in the Public Sector (by Heads of Development) since 1951-52

(Rs. crores)

	First Five Year Plan 1951-52 to 1955-56	*Second Five Year Plan 1956-57 to 1960-61*	*Third Five Year Plan 1961-62 to 1965-66*	Annual Plans *1966-67*	*1967-68*	*1968-69*
	(1)	(2)	(3)	(4)	(5)	(6)
1. Agriculture and Community Development	290 *(14.8)*	549 *(11.8)*	1103 *(12.8)*	331 *(15.5)*	363 *(16.3)*	328 *(14.0)*
2. Irrigation and Power	583 *(29.8)*	882 *(18.9)*	1919 *(22.2)*	546 *(25.5)*	542 *(24.3)*	493 *(21.1)*
3. Industry and Mining	97 *(4.9)*	1125 *(24.1)*	1955 *(22.7)*	558 *(26.1)*	564 *(25.3)*	581 *(24.9)*
4. Transport and Communications	518 *(26.4)*	1261 *(27.0)*	2116 *(24.5)*	423 *(19.8)*	419 *(18.8)*	426 *(18.2)*
5. Social Services and Miscellaneous	472 *(24.1)*	855 *(18.2)*	1537 *(17.8)*	283 *(13.1)*	342 *(15.3)*	509 *(21.8)*
Total (1 to 5)	**1960** *(100.0)*	**4672** *(100.0)*	**8630** *(100.0)*	**2141**[1] *(100.0)*	**2230**[2] *(100.0)*	**2337** *(100.0)*

[1]Total actual expenditure works out to Rs. 2137 crores; comparable sector-wise data are not available.

[2]Total expenditure expected to be Rs. 2205 crores; comparable sector-wise data are not available.

Source : Reserve Bank of India, *Report on the Currency and Finance for the Year 1967-68.* Bombay, 1968.

4

Constitutional Provisions Regarding Public Debt

In the Constitution, the borrowing provisions are contained in Articles 292 and 293. Article 292 empowers the Union government to borrow (and to give guarantees) upon the security of the Consolidated Fund of India within limits fixed by the Parliament. Article 293 empowers the State governments to borrow within India (and to give guarantees) upon the security of the Consolidated Fund of the State(s) within limits fixed by the State legislature(s). In terms of the provisions of Articles 293(3) and 293(4), "a State may not without the consent of the Government of India raise any loan, if there is still outstanding any part of a loan which has been made to the State by the Government of India or by its predecessor government or in respect of which a guarantee has been given by the Government of India or by its predecessor government" and that "a consent under Article 293(3) may be granted subject to conditions, as the Government of India may think fit to impose."

The constitutional provisions clearly point to the fact that basically the State governments' ability and power to borrow is dependent on the discretion and consent of the Union government[7] and in consequence, the latter may curb it if considered necessary in the given circumstances. Article 293 also provides that the Government of India may give loans to the States or give guarantees for State loans. The States are prohibited from raising loans in foreign countries as 'foreign loans' is a subject over which the Union government has exclusive jurisdiction (Item No. 37, List I of the Seventh Schedule). External loans, moreover, raise a transfer problem which exercises a pressure on foreign payments. Sometimes, they also raise international complications and it is, therefore, a desirable restriction on the power of the States to raise loans.

Competition between the Union and the State governments in borrowing has been avoided by the Reserve Bank of India which manages the public debt operations of the Union as well as the State governments. Besides, all the States have borrowed from the Union government, and, therefore, its consent is necessary before they can float loans in the open market. This helps in fixing an order of priority of State borrowings and the timing of the loans. It also avoids competition which would cause unhealthy movements in the money market to the disadvantage of all.

5

Debt and Other Liabilities of the Union Government

Ordinarily, the debt and liabilities of the Union government are classified into : (1) public debt, and (2) other liabilities. The public debt is further categorised into : (a) the debt raised in India, comprising of 'permanent debt' and 'floating debt', and (b) debt raised outside India. Other liabilities are also categorised further into 'unfunded debt' and 'reserve funds and deposits'. The terms 'permanent debt' or 'funded debt' cover all debts which at the time of issue have a currency of more

[7]The States are heavily indebted to the Union government (the outstanding loans as at March 31, 1968 amounting to Rs. 5149 crores) and cannot, therefore, float loans without the express consent of the latter. It follows that the Union government can direct and guide, through the Reserve Bank of India, the State governments about the form of their borrowings, the choice of their lenders, and the amounts so that the actions of the latter do not run counter to the objectives, policies and the overall strategy of the Union government especially in the context of planning.

than twelve months, i.e., repayable after twelve months of the date of issue of the loan.

The 'permanent' or 'funded' debt may be for a specified period of time or for an indefinite period to be paid at the will of the government. In the former case the debt would be known as 'terminable funded debt' and in the latter case the debt will be known as 'interminable funded debt'.

A 'floating' or 'temporary' debt is purely temporary in nature and is repayable within twelve months of the date of issue. It includes treasury bills, ways and means advances from the Reserve Bank of India, etc.

In most of the countries, unfunded debt is included in the floating debt, there being no distinction between the two. But in India the term unfunded debt is used in a special sense. The term has been reserved for certain interest bearing obligations of the Government of India as Post Office Savings Bank Deposits, 15-year Annuity Certificates, Cumulative Time Deposits, 12-year National Defence Certificates, 4 1/2% 10-year National Savings Certificates, etc., and other unfunded debt.

The trends in and the structure of the debt and other liabilities of the Union government since 1950-51, categorized as aforesaid, are reflected in the Table 3 below :

Table 3 : Debt and Other Liabilities of the Government of India since 1950-51

(Rs. crores)

	At the end of					
	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Revised)*	*1967-68 (Revised)*
	(1)	(2)	(3)	(4)	(5)	(6)
A. Public Debt						
1. *Debt Raised in India*	2022	2329	3975	5415	6214	6556
(1) Permanent Debt	1445	1521	2594	3462	3606	3776
(2) Floating Debt	577	808	1381	1953	2608	2780
2. *Debt Raised Outside India*	32	114	761	2591	4624	5401
Total Public Debt (1+2)	**2054**	**2443**	**4736**	**8006**	**10838**	**11957**
B. Other Liabilities						
1. *Unfunded Debt*	447	753	1519	2751	2911	3171
2. *Reserve Funds, Deposits, etc.*	364	315	289	572	606	731
Total Other Liabilities (1+2)	**811**	**1068**	**1808**	**3323**	**3517**	**3902**
C. **Total Debt and Liabilities**	**2865**	**3511**	**6544**	**11329**	**14355**	**15859**
D. *Percentage of A2 to C*	1.1	3.2	11.6	22.9	32.2	34.1

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay, 1968.

The outstanding debt and other liabilities of the Government of India, it may be observed, increased from Rs. 2865 crores as on March 31, 1951 to Rs. 3511 crores as on March 31, 1956, a growth of 22.5 per cent over the First Plan period. The corresponding growth over the Second Plan period was of the order of 86.4 per cent, i.e., the total obligations increased from Rs. 3511 crores as on March 31, 1956 to Rs. 6544 crores as on March 31, 1961. There was a further step-up to Rs. 11329 crores as on March 31, 1966 showing a growth of 73.1 per cent over the Third Plan period. The total debt and liabilities outstanding as at March 31, 1968 were Rs. 15859 crores exhibiting a more than five-fold increase as compared to the outstandings at the start of the First Five Year Plan.

Another significant development in the trends in the debt and other liabilities of the Government of India has been the growth of external obligations. The outstandings relating to the debt raised outside India, which constituted 1.1 per cent of the total outstandings as on March 31, 1951 increased to 3.2 per cent as on March 31, 1956, to 11.6 per cent as on March 31, 1961 and further to 22.9 per cent as on March 31, 1966. The ratio which stood at 34.1 per cent as on March 31, 1968 clearly emphasises the growing relative importance of external obligations in total obligations.

The public debt of the Government of India can also be classified in another way. Such a classification may be: (a) dated and non-terminable rupee loans; (b) treasury bills; (c) small savings; (d) other obligations; and (e) external debt. Items (a), (b), (c) and (d) represent the rupee indebtedness of the Union government and may be assumed to be held within the country.[8] This excludes, however, a portion of foreign debt held in the form of rupee counterpart funds. The trends and structure of the public debt of the Union government, classified as such, is given in the Table 4 on page 233.

Ways and Means Advances from the Reserve Bank of India

It generally happens that public revenues do not come in regularly and uniformly throughout all the months of the year, whereas expenditure is more or less distributed uniformly throughout the year. For instance, in India, current revenue generally falls short of current expenditure in the period from April to December; the last quarter from January to March registers a good surplus of revenue over expenditure. Also, sometimes, exceptionally heavy payments have to be made at a certain period of the year by the government when the revenue has not sufficiently accumulated to meet them. To enable them to tide over such temporary difficulties, Government of India take advances from the

[8]Perhaps an insignificant amount of the rupee debt of the Union government might be held by the non-residents.

TABLE 4

Debt and Other Obligations of the Government of India since 1950-51

(Rs. crores)

	Rupee loans	*Percentage (1) to (9)*	*Treasury bills*	*Percentage (3) to (9)*	*Small savings*	*Percentage (5) to (9)*	*Other obligations*	*Percentage (7) to (9)*	*Total internal debt*	*Percentage increase (+) or decrease (—) over the previous year(s)*	*External debt*	*Percentage increase(+) or decrease(—)*	*Total debt and other obligations (9)+(11)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
1950-51	1438	58.2	364	14.8	337	13.6	330	13.4	2469		32		2501
1955-56	1509	48.9	595	19.3	580	18.8	399	12.9	3082	24.9	114	256.3	3196
1960-61	2571	46.8	1107	20.1	982	17.9	834	15.2	5494	78.2	761	567.5	6255
1965-66	3425	41.9	1612	19.7	1549	19.0	1580	19.4	8166	48.6	2591	240.5	10757
1966-67	3557	39.0	1920	21.0	1667	18.3	1981	21.7	9125	11.7	4624	78.5	13749
1967-68	3732	38.4	2014	20.7	1762	18.1	2219	22.8	9727	6.6	5401	16.8	15128

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay 1968.

Reserve Bank of India with which they do their financial business.

In terms of Section 17(5) of the Reserve Bank of India Act, 1934, the Bank is authorised to make, to the Central and State governments, ways and means advances which are repayable not later than three months from the date of making the advance. There are no statutory provisions as regards either the rate of interest to be charged or the maximum amount of the advance. These matters are, however, regulated by the respective agreements or arrangements which the Reserve Bank has made with the Central and State governments. According to these, the Reserve Bank is prepared to grant advances to the government(s) concerned at a rate of interest not exceeding the bank rate. The actual rate charged has been one per cent below the bank rate. Interest is charged for a minimum period of seven days on each advance. In the case of the Central government the total of such advances outstanding at any time should not exceed the minimum balance which it has agreed to maintain with the Bank and in the case of the State governments twice the level of their agreed minimum balance. Outstanding advances are repayable in full not later than three months from the date of the initial advance. These advances are granted without any collateral.

The Treasury Bills

The purpose for the issue of treasury bills is the same as in the case of ways and means advances, namely, to finance a government's temporary excess of expenditure pending the collection of revenue.

There are several considerations which enter into the decision whether to take a ways and means advance or to sell treasury bills on a particular occasion. *Firstly*, the size of the requirement has to be considered. If the amount required is small it is not worthwhile to have recourse to treasury bills. A ways and means advance is more suitable in such a case. *Secondly*, the period of the requirement has to be considered. If the deficiency is to last for less than three months, the ways and means advance is the better course. Where deficiency exeeds three months, treasury bills are generally more suitable, but the state of the money market at the time of their repayment must also be taken into consideration. *Lastly*, the comparative cost of the two alternative courses must be the chief consideration. The rate of interest payable is the main factor; also the fact that while a ways and means advance can be repaid at any time and, therefore, interest is payable only for the period it is outstanding, in the case of treasury bills, repayment cannot be made earlier than the term of the issue in question and interest is paid for the full period.

The Reserve Bank also sell treasury bills to the public, whenever considered necessary, on behalf of the Central government, by tender at the weekly auctions. Treasury bills are issued for a currency of 91 days. The sale of treasury bills provides short-term finance to government and also helps to absorb any excess liquidity in the money market.

Capital Outlay and loans Advanced by the Union Government

Creation of public debt by the governments of today becomes necessary to meet certain important situations. *Firstly*, loans may be floated for meeting the normal budget deficits due to some unforeseen contingency. *Secondly*, borrowing may become necessary for meeting large abnormal expenditure in emergencies. The most extreme example of such situations is war. *Thirdly*, loans may be used for financing commercial enterprises run by the government. They are generally productive enterprises which bring in every year a net revenue from which may be paid the annual interest on debt together with the annual depreciation charges of the assets. *Fourthly*, debts may be incurred for those public activities, such as the creation or expansion of education or health services, which improve and enhance the general social well-being and productive capacity of the nation, but which yield no direct financial return or revenue for the payment of interest and the redemption of the principal. *Finally*, the government may borrow not for a specific productive enterprise or social service, but for planned economic development in general. The funds so obtained may not be earmarked for a praticular project, but may be used, as is currently being done in India, for financing the development Plan in general.

The capital outlay of the Union government as classified into : (a) outlay on departmental undertakings; (b) investments in autonomous corporations, government companies, etc.; and (c) other capital outlay, since 1950-51 is given in the Table 5 below :

Table 5 : Capital Outlay and Loans and Advances by the Government of India

(Rs. crores)

	At the end of					
	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 (Accounts)*	*1966-67 (Revised)*	*1967-68 (Revised)*
	(1)	(2)	(3)	(4)	(5)	(6)
A. Capital Outlay	**1488**	**1866**	**3590**	**6585**	**7616**	**8186**
1. Outlay on Departmental Undertakings	895	1064	1682	3030	3294	3504
2. Investments in Autonomous Corporations, Companies, etc.	260	321	960	1798	2127	2304
3. Other Capital Outlay	333	481	948	1757	2195	2378
B. Loans Advanced	**221**	**943**	**2535**	**5379**	**6409**	**7255**
C. Total Capital Outlay and Loans Advanced (A+B)	**1709**	**2809**	**6125**	**11964**	**14025**	**15441**

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68*. Bombay, 1968.

6

Debt Position of the States

The public debt of the State governments may be classified as follows: (a) permanent debt; (b) floating debt; (c) unfunded debt; (d) loans from the Union government; and (e) other debt.

The permanent debt represents rupee loans issued to the public. It includes cash and conversion loans as well as bonds issued in compensation for the abolition of intermediary rights in land. The outstanding permanent debt which stood at Rs. 58 crores on March 31, 1951, increased more than four-fold during the First Plan period to Rs. 265 crores on March 31, 1956. During the Second Plan period, it increased from Rs. 265 crores on March 31, 1956 to Rs. 493 crores on March 31, 1961, i.e., an increase of 86 per cent. The corresponding percentage increase during the Third Plan period works out at 67.1 per cent. The outstandings on account of permanent debt amounted to Rs. 970 crores on March 31, 1968.

The floating debt consists of ways and means advances from the Reserve Bank of India and short-term loans secured from the State Bank of India.

The unfunded debt consists of State provident funds, savings bank deposits, employees' insurance contributions, etc., and against the total debt position of the States, its significance has progressively been declining since 1950-51.

Loans from the Union government are given mainly for the Centrally-assisted schemes and Centrally-sponsored schemes, although some loans are also granted for non-Plan purposes. That means a bulk of these loans are given for specific projects. The outstandings which were put at Rs. 155 crores on March 31, 1951 rose to Rs. 876 crores on March 31, 1956. The outstandings increased further to Rs. 2016 crores and Rs. 4101 crores by the end of Second Plan and Third Plan periods respectively, i.e., as on March 31, 1961 and March 31, 1966. The figure stood at Rs. 5149 crores as on March 31, 1968.

Table 6 on page 237, brings out the trends in the debt position of the States since 1950-51.

The public debt of the States may be defined to include permanent debt, floating debt and unfunded debt only. A portion of 'other debt' may also be included in such a definition but for the difficulty of dividing it into components readily. Parmanent debt is comparable to the rupee loans of the Union government; floating debt could be put at par with the treasury bills and the ways and means advances taken by the Union government from the Reserve Bank of India; and the unfunded debt with its counterpart in the debt position of the Union government.

Table 6 : Debt Position of the State Governments since 1950-51

(Rs. crores)

	At the end of					
	1950-51 (Accounts)	*1955-56 (Accounts)*	*1960-61 (Accounts)*	*1965-66 Accounts)*	*1966-67 (Revised)*	*1967-68 (Revised)*
	(1)	(2)	(3)	(4)	(5)	(6)
A. Public Debt	**215**	**1149**	**2602**	**5250**	**5780**	**6368**
1. Permanent Debt	58	265	493	824	905	970
2. Floating Debt	2	8	42	170	32	34
3. Loans from Union Government	155	876	2016	4101	4680	5149
4. Other Debt	—	—	51	155	163	215
B. Unfunded Debt	**30**	**83**	**135**	**195**	**220**	**261**
C. Gross Total Debt	**245**	**1232**	**2737**	**5445**	**6000**	**6629**

Source : Reserve Bank of India, *Report on Currency and Finance for the Year 1967-68.* Bombay, 1968.

Loans from the Union government do not necessarily form part of the public debt of the States. The item indicates, however, the magnitude of the transfer of resources from the Union to the States in the form of loans since 1950-51. In view of the ever-increasing dependence of the States on the Union for financing various schemes assisted or initiated by the Union government, this category of States' indebtedness is bound to grow in relative importance for the years to come.

7

States' Borrowing from the Reserve Bank of India and the Problem of Unauthorised Overdrafts

All the State governments, except Jammu and Kashmir government, have entered into arrangements with the Reserve Bank of India, under Section 21A of the Reserve Bank of India Act, 1934, to enable the latter to handle their monetary transactions. Section 17(5) of the Act provides that the Reserve Bank of India may make advances to the State governments repayable in each case not later than three months from the date of the advance. As regards procedures governing State governments' borrowings from the Reserve Bank of India, the loan transactions take mainly three forms : (1) ways and means advances; (2) special ways and means accommodation; and (3) extraordinary form of borrowings by the State governments, known as 'unauthorized overdrafts'.

Regarding ways and means advances, the basis for devising limits for such borrowings have been related to the minimum balances which each State is required to hold with the Reserve Bank of India. Presently, the States can draw upto twice the amount of these minimum balances. "This lending is almost automatic once a request comes from the State government concerned and does not involve any complicated procedures. For the purpose of availability of this facility, the State governments are required to execute a promissory note for the entire limit of advances and a letter of continuity (renewal) if necessary is obtained on 1st July every year. Under a revised procedure introduced from September 19, 1965, the promissory notes are to be renewed once in two years."[9] No cover is necessary for such advances.

As regards special ways and means accommodation, "the theoretical limit of this type of advance is Rs. 2 crores and is granted against hypothecation of Central government securities. In practice, this theoretical maximum is not always adhered to, the outer limit being allowed to vary with the size of Central government securities the States are in a position to pledge......The loans are normally repayable within three months but can be renewed after expiry of the usual period......The debtor governments clear the amounts borrowed either through authorizing the Reserve Bank for sale of the securities pledged or making good the amount out of normal budgetary receipts."[10]

The extraordinary form of borrowing, commonly known as 'unauthorized overdrafts' are considered unauthorized in the sense that no prior arrangements are entered into between the borrowing State governments and the Reserve Bank of India. Such borrowings arise *either* because the limits agreed to between the States and the Reserve Bank of India, for ways and means advances and special ways and means commitments are exceeded *or* because these advances are not repaid within a period of three months. "In view of the delicate relationships with the State governments, the Reserve Bank cannot dishonour these cheques. All that it does under the circumstances, is to draw the attention of the State governments to the debit balances and to request them to clear them as quickly as possible......The Central government is also kept informed of the position. Sometimes these overdrafts are cleared through

[9]Administrative Reforms Commission, "Report of the Working Group on State Finances and Centre-State Financial Relations" in the *Report of the Study Team on Financial Administration*. New Delhi, May 1967, p. 376,

[10]*Ibid.*

adjustment against Central assistance to the concerned State for Plan schemes sanctioned by the Government of India. However, it is a rare occasion that these overdrafts are cleared in this manner. All sorts of political considerations supervene and eventually it is the Central government which is left to hold this unwanted baby......Thus the State goverments' debt undergoes a metamorphosis and results in being a liability of the Central government, which treats them as a special loan to the concerned State. The repayment schedule of such loans is then fixed in consultation with the defaulting State governments though there is no standard procedure for the purpose."[11]

"The persistence and large size of unauthorized overdrafts are a matter of very serious concern. Apart from the contravention of Article 293(3) of the Constitution and the agreements entered into under Section 21A of the Reserve Bank of India Act, the occurance of such overdrafts and their practically automatic clearance by the Centre through *ad hoc* loans have grave effects on the national economy. In all federations, it is the sole responsibility of the Central government to take decisions regarding the need for and the extent of deficit financing in the context of overall economic considerations. No country with a unified currency system can afford to have more than one independent authority taking measures which result in increase of money supply. Unauthorised overdrafts violate this fundamental principle of sound monetary management. The benefits of this violation go to a few States which draw on the national resources at their own will without any scrutiny of their needs at the national level, while the burdens are borne by all including the States which are less prosperous. There is a serious danger that the example of having recourse to such unauthorized overdrafts by certain States, followed by their almost routine clearance by the Centre, may prove infectious."[12]

It may be observed that as the procedures and practices stand, the regulation of 'normal ways and means advances' and 'special ways and means accommodation' by the Reserve Bank of India does not pose any significant problem. Moreover, the existing procedures and practices can always be reviewed and refined further in the light of emerging situations out of expanding State budgets. Viewed from an overall context, the idea behind State governments taking ways and means advances from the Reserve Bank of India is to cover the temporary shortfalls in their revenues so that their commitments to budget expenditures should not be adversely affected. On the basis of the trends of the State governments' revenues and expenditures, and their size, a realistic

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[11]*Ibid.*

[12]*Report of the Fifth Finance Commission (Interim)*, New Delhi, October 1968, p. 13.

measure for fixing borrowing limits can easily be located.

A major difficulty arises, however, about the manner in which the Reserve Bank of India may be in a position to prevent the State governments from overdrawing their accounts. But before a solution to the problem is thought of, it would be worthwhile to search for the causes which lead the State governments to overdraw their accounts. Some of the more important causes may be divided into two groups according to their nature : (a) temporary difficulties arising from the uneven flow of receipts or expenditure and the inadequacy of the limits of normal 'ways and means advances' and 'special ways and means accommodation' with which they could be met; and (b) relatively more chronic imbalances between the resources of the States and their commitments, inadequate devolution, and the absence of suitable mechanism to deal with unforeseen difficulties.

The factors leading to the first category of difficulties, i.e., temporary difficulties, may be : (1) delays in the receipt of devolutions, statutory grants and Plan assistance from the Union government; (2) payments by any State government on account of other State governments and the Central government—which are initially met from the State balances; (3) inadequacy of the limits of 'ways and means advances' and 'special ways and means accommodation'; (4) certain unanticipated developments facing the State, e.g., famines, floods, etc.; and (5) advances continuing beyond three months.

The aforesaid difficulties are further accentuated by another factor. In view of the sprawling machinery of the State governments, it is possible that the disbursing officers, widely spread spacially, may draw amounts from the Consolidated Fund of the State concerned in excess of the balance at any given point of time. The monetary transactions of the State governments go on simultaneously at over 2000 Treasuries, Sub-Treasuries and banks. Owing to large number of places, it is not possible for the Reserve Bank of India to ensure beforehand that payments on behalf of a State government do not exceed the balance held by it by more than the limit specifically agreed to. These factors explain only the temporary unauthorized overdrafts which should get cleared as soon as progressive receipts reach up to progressive expenditure.

The second group of difficulties which can lead to persistent unauthorized overdrafts may be attributed to: (1) imbalance between resources and commitments of the States; (2) problems arising out of emerging situations; and (3) repayment of Central loans.

Imbalance Between Resources and Commitments

The State governments represented to the *fifth* Finance Commission that there was a great amount of disparity between their resources and commitments under the Constitution. Recent technical and economic developments leading to integration of the national economy have resulted in an effective centralization of a number of highly productive taxes leading to a growing imbalance between States' own resources and commitments and the increasing dependence of the States on the Union government in the form of share in Centrally raised taxes, statutory non-Plan grants-in-aid and the discretionary Plan grants.

Problems Arising out of Changed Circumstances

Many States represented to the *fifth* Finance Commission that while the size of State Plans and Central Plan assistance were reviewed and revised from year to year, the recommendations of the Finance Commission remained in force for longer periods without any such review. If due to changed circumstances, such as increases in the cost of living requiring payment of additional dearness allowance to the employees, the States have to incur substantially larger non-Plan expenditure, there is no machinery as at present for providing increased devolution of resources to the States to meet the increasing deficits.

Repayment of Central Loans

Besides the requirements of unforeseen circumstances which have led to the difficulties in the States' revenue budgets, the volume of repayment of Union government's loans has in recent years resulted in a considerable strain on the capital budgets of the States. This has resulted in substantial amounts of non-Plan capital deficits which have largely been responsible for unauthorized overdrafts by several States. According to the existing arrangements large repayments of Central loans have to be made by the States in the month of October and this creates ways and means difficulties for some States during that month and the succeeding few months.

The *fifth* Finance Commission have been requested, according to their terms of reference, to probe into the problem of unauthorised overdrafts on the part of certain States with the Reserve Bank of India and to recommend the procedure to be observed for avoiding such overdrafts.

As regards ways and means advances which remain outstanding for more than three months, a period specified in Section 17(5) of the Reserve Bank of India Act, 1934, the *fifth* Finance Commission observe that "the prolonged continuance of substantial ways and means advances is likely to result in their exceeding the permissible limits when there is a small time-lag in the inflow of receipts or unanticipated increase in expenditure. The Reserve Bank has been allowing such advances to continue beyond three months without renewal and without calling for their repayment, on the view that the continuance of advances in this manner does not contravene Section 17(5) of the Reserve Bank of India Act. We think that it is necessary to review such advances instead of allowing them to continue automatically. We suggest that the Reserve Bank should keep a continuous watch over the ways and means position of each State, and whenever any advance is found to continue beyond the period of three months, the Bank should examine whether it is due to a long-term imbalance in the State's budgetary position or any temporary reasons. Where the continuance of the advance is not due to a long-term imbalance, it should be formally renewed by the Bank and treated as a fresh advance. In other cases the Bank should call upon the State government to repay the advance, and in the case of default, it should be dealt with as an unauthorised overdraft."[13]

Regarding 'unauthorised overdrafts', the *fifth* Finance Commission observe that "in the context of overall shortage of financial resources available to the Central and State governments and rising demands for expenditure in a welfare State, it is inevitable that the State governments, even after receiving all possible devolution of tax shares and grants as well as Plan assistance from the Centre, will not find themselves in a position to meet their needs in full. If the evil consequences of unauthorised overdrafts are to be avoided, it is a matter of vital importance that, inspite of the relative inadequacy of their resources, the State governments must have balanced budgets and they should not embark upon any expenditure in excess of their available resources. Where, after the adoption of a balanced budget, there are fresh developments likely to result in lower receipts or higher expenditure, the responsibility for restoring the budgetary balance must necessarily lie on the State government and it should take timely steps to mobilize sufficient additional resources or curtail its expenditure to the necessary extent......Even when there is a balanced budget, it is necessary that a careful watch is maintained on the flow of receipts and expenditure throughout the year...... With the adoption of balanced budgets and an effective system of control over expenditure, the States should be able to avoid any of the difficulties in their ways and means position."[14]

A summary of recommendations of the *fifth* Finance Commission regarding adoption of measures for avoiding unauthorized overdrafts is given below :[15]

(1) The State governments must accept the basic position that the

[13] *Ibid.*, p. 21.
[14] *Ibid.*, p. 22.
[15] *Ibid.*, pp. 24-27.

facility of ways and means advances is meant only for meeting temporary requirements and not for financing general budgetary needs.

(2) The States should, as a matter of necessary fiscal discipline, balance their budgets and manage their affairs within the resources available to them. They should adopt the policy of having overall balanced budgets both at the beginning of the year and at the time of revised estimates.

(3) There should be no deficit financing at the State level and the size of the State Plans should be regulated strictly within the States' own resources and available Central assistance. Ways and means advances should not be considered as a resource.

(4) While the present position regarding limits of ways and means advances does not call for any immediate change, periodical reviews of the limits should be made by the Reserve Bank.

(5) The State governments which do not have sufficient Central government securities may, in special difficulties, avail themselves of such further clean advances as the Reserve Bank can allow subject to being satisfied about repayment in time.

(6) The Central government may consider more frequent releases of the States' share of income tax during the last two quarters.

(7) To avoid ways and means difficulty due to delay in the final adjustment of Plan assistance, the State governments should arrange for speedy reconciliation of departmental actuals with the accounts maintained by the Accountants General during the course of the year. Efforts should also be made to expedite completion of audit.

(8) The Central government may consider suitably modifying the procedure for consolidation of loans to States so that their repayment in instalments may correspond with release of Central funds to States and the usual time of floatation of their market loans.

(9) Where a State government experiences difficulties due to unforeseen developments, it should make efforts to raise further resources or to reduce expenditure, instead of incurring unauthorised overdrafts. If inspite of all possible measures it cannot meet the additional expenditure which is immediately necessary, it may apply to the Central government for a short-term loan to tide over the difficulty. The Central government should in such cases provide the necessary assistance to the States.

(10) The Planning Commission should, in their annual Plan review, take into account the adverse effect of the new developments and if necessary modify the size of the annual Plan of the State concerned.

(11) Whenever a deficit on non-Plan capital account is anticipated, the State government should consider reducing its non-Plan capital

expenditure and make efforts to increase its capital receipts including better recovery of loans. If the capital budget cannot be balanced inspite of such efforts, the Central government may consider deferring the repayment of Central loans falling due during the year to the necessary extent.

(12) Every State should have an effective ways and means section in its Finance Department. Forecasts of the ways and means position should be prepared, on the basis of which necessary corrective measures should be taken.

(13) The States may consider the introduction of a system in the nature of 'letters of credit' in the case of major spending departments and a monetary limit of expenditure may be fixed for each disbursing officer.

(14) The Reserve Bank should keep a continuous watch over the ways and means position of each State and the ways and means advances should not be allowed to continue beyond three months automatically. The Bank should formally renew an advance only where it is satisfied that its continuance is not due to a long-term imbalance in the State's budgetary position. In other cases the State should be called upon to repay the advance and in case of default it should be dealt with as an unauthorised overdraft.

(15) Where an unauthorised overdraft takes place, the Reserve Bank should issue a notice to the State government as at present, and at the same time inform the Government of India. It should be the duty of the State government to take immediate steps for clearing the overdraft within the notice period, failing which the Reserve Bank must proceed to stop payments.

(16) In view of the serious consequences which would ensue from stoppage of payments, the Government of India should help the State to regain a position of budgetary balance and to achieve fiscal discipline. To do so it should assist the State to clear the overdraft It must be clearly recognised that this would be possible only where the State does not persistently follow policies resulting in financial difficulties and that the Central government cannot clear unauthorised overdrafts repeatedly.

(17) For this purpose the Government of India should, as soon as it is informed by the Reserve Bank about issue of notice to the State, ascertain from the State what steps it proposes to take to clear the overdraft. If the State government is not in a position to clear the overdraft it should urgently approach the Central government for special assistance. The Central government should, where it decides to assist the State, release in advance the State's share of devolution or Plan assistance payable during the year. When the amount due to the State during the year is not sufficient for the purpose, further assistance should be given as

an ad hoc loan to be adjusted against the devolution or Plan assistance falling due during the next year.

(18) The Central government should also have consultations with the State government to ascertain the causes of its difficulties and to ensure that the situation does not recur. It should depute a team of its officers, including a nominee of the Planning Commission, to visit the State for assessing the situation and recommending remedial action, and also considering whether any further temporary loan assistance is necessary for tiding over the immediate difficulties of the State.

(19) The Central government should call upon the State to adopt such measures as it may deem necessary. For the purpose of securing effective control over expenditure so as to keep it within actual receipts, it should be open to the Central government to nominate an officer to be associated with the Finance Department of the State. The State government should comply with these requirements.

(20) If a State government persists in incurring an unauthorised overdraft it would not be proper that the Central government should clear it and the consequences of failure to clear it will have to be faced. In such a case, or where an overdraft cannot be cleared in accordance with the procedure we have suggested, the Central government would have to take a view whether the crisis resulting from stoppage of payment of the State's cheques should be allowed to develop or it would be expedient to forestall it by invoking its Constitutional powers.

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12

Price Policy of Public Enterprises

Organisation and Structure

Prior to 1951-52, the year planning for economic development commenced in this country, activity in the public sector was confined to railways, ports, communications, broadcasting, irrigation and power, and a few departmental industrial undertakings such as the ordinance factories, railway workshops, post and telegraph workshops, etc. Since then the growth and expansion of the public sector, both in dimension and direction, has been phenominal. Today, public undertakings cover a vast and varied range of activities, e.g., mining and metallurgy; heavy electricals; heavy engineering; machine tools; petroleum; heavy chemicals and fertilizers; drugs and pesticides; building of ships, aircraft and locomotives; transport, aviation and shipping; building and construction; banking, insurance and trade; and industrial financing.[1] This large scale expansion of public sector during the last eighteen years gives an idea about the growing entrepreneurial effort on the part of the State in this country.

[1]Except for the nationalization of life insurance, air transport, Imperial Bank of India, and the acquisition of controlling interests in a few units like the Praga Tools, the Hindustan Shipyard, the Hindustan Zinc, etc., the growth of the public sector represents the entrepreneurial effort of the State. The investment in the public sector has thus been strategically placed so as to put the public enterprises in an important position of influence in the economy.

Judged from the magnitude of investment outlays, the investment in the Union government's commercial and industrial undertakings alone would have been more than Rs. 3500 crores by March 31, 1969.

The setting up of public enterprises has proceeded in accordance with the industrial policy of the Government of India as embodied in the two Industrial Policy Resolutions of April 1948 and April 1956. The 1948 Resolution called for a dynamic national policy directed towards a continuous increase in production by all possible means together with measures to secure its equitable distribution. The Resolution stressed the need for the State to play a progressively active role in the development of industries. The Resolution stated that "for some time to come, the State could contribute more quickly by expanding its present activities where it is already operating and by concentrating on new units of production in other fields rather than acquiring and running existing units." The public and private sectors were thus assigned complementary roles in the promotion of industrial development. The manufacture of arms and ammunition; development, production and control of atomic energy; and the development, ownership and management of railways were declared to be the exclusive monopoly of the State. The responsibility of setting up new undertakings in six basic industries (i.e., coal; iron and steel; aircraft manufacture; ship building; mineral oils; and manufacture of telephone, telegraph and wireless apparatus, excluding radio receiving sets) was reserved to the State.

The initiative and direct participation in the industrial sphere by the State were thus restricted to a comparatively narrow field. In view of subsequent developments in socio-economic thinking, the need arose for further amplification of the policy and for extending the scope of public sector in the industrial set-up. The Directive Principles of State Policy enshrined in the Constitution adopted on January 26, 1950 indicated the socio-economic goals towards which the efforts of the State were to be oriented. In the light of these principles, it was considered that planning as a means for economic development assumed a vital role, and accordingly, Planning Commission was set up in March 1950.

While the First Five Year Plan, covering the period 1951-52 to 1955-56, was under implementation, the Parliament adopted a 'socialist pattern of society' as the principle objective of the socio-economic policy of the State. In the light of these developments, the Government of India reformulated their industrial policy and adopted the Industrial Policy Resolution of 1956. According to 1956 Resolution : "The adoption of the socialist pattern of society as the national objective, as well as the need for planned and rapid development, require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector. Other industries which are essential and require investment on a scale which only the State, in present circumstances, could provide, have also to be in the public sector. The State has, therefore, to assume direct responsibility for the future development of industries over a wider area."

The 1956 Resolution classified industries into three categories. In the *first* category were placed the industries the future development of which was to be the exclusive responsibility of the State. The *second* category consisted of industries which would be progressively State-owned and in which the State would, therefore, generally take the initiative in establishing new undertakings, but in which private enterprise would also be expected to supplement the effort of the State. The *third* category included all the remaining industries where future development would generally be left to the initiative and enterprise of the private sector. It is in pursuance of this policy that the government have set up an increasing number of industrial and commercial undertakings and thus the public sector has come to occupy a commanding position in the economy and to play a strategic role towards a 'self-reliant and self-generating economy'.

Categorised according to the form of organisation, public sector undertakings can be classified under three groups : (1) undertakings run directly by the Departments/Ministries or executive agencies of the government, commonly known as 'departmental undertakings'; (2) 'statutory corporations', established by special Acts of Parliament; and (3) joint stock companies incorporated under the Companies Act, 1956, popularly known as 'government companies'.

Departmental Undertakings

The principal characters of a departmental undertaking are : (a) it is financed by annual appropriations from the Consolidated Fund and all, or a major share of, its profits/surpluses are paid into the Consolidated Fund; (b) it is subject to the budget, accounting and audit controls applicable to government activities; (c) its permanent staff consists of civil servants, and their conditions of recruitment and service are the same as for other civil servants; and (d) it can be sued only by following the procedure prescribed for filing suits against the government. The more important departmental undertakings in the Central sector are : Railways; Posts and Telegraphs; India Security Press; Currency Note Press; Neemuch and Mandsaur Opium Factories; Government Opium and Alkoloid Works Gazipur; Overseas Communication Service; Light Houses and Light Ships; Delhi Milk Scheme; Forest Department, Anadaman; and Kolar Gold Mines.

Statutory Corporations

Efficient, economical and effective conduct of the public enterprises demands that their form of organization should be such as to afford the management an adequate sphere of independence of functioning within a broad framework prescribed by the Statute. Independence of day-to-day administration on the one hand and faithful carrying out of the obligations set in the Statute so as to be answerable to the legislature must go hand in hand. The public corporation *or* statutory corporation is designed to satisfy these twin requirements. "Admittedly, Western opinion has run fairly strongly in favour of the public corporation, on the grounds that it provides just the right combination of commercial freedom and Government control."[3]

A public corporation may be defined as a legal entity created by a special Act of Parliament, but exterior to the government organisation, financially independent, for carrying on specific functions prescribed in the Statute. The main characteristics of a statutory corporation are: (a) it is created by a special law defining its objects, powers and privileges, and prescribing the form of management and its relationship with government departments; (b) it is a body corporate and can sue and be sued, enter into contracts and acquire property in its own name; (c) except for appropriations to provide capital or to cover losses, it is usually independently financed; it obtains funds by borrowing either from the government or, in some cases, from the financial institutions or the public and through revenues derived from the sale of goods and services, and has the authority to use and re-use its revenues; (d) it is ordinarily not subject to the budget, accounting and audit laws and procedures applicable to government departments; and (e) excluding the officers taken from government departments on deputation, the employees of statutory corporations are not civil servants, and are not governed by government regulations in respect of conditions of service. "Deriving its existence and authority directly from a Statute, such a corporation is usually characterised by a body of management, a management board, invested with such greater autonomy and much larger financial and other powers than is usual for officials heading an undertaking managed directly by a ministry or a government department. At the same time, the statutory nature of the corporation and its management, while reserving to the minister concerned or the executive government a large measure of initiative, appointment to top management and general supervision relieves them, at the same time, of the primary responsibility for the detailed

[3]Hanson, A.H., *Public Enterprise and Economic Development*. London: Routledge and Kegan Paul, 1959, p. 357.

working of the corporation and its business."[3]

A list of statutory corporations engaged in the commercial and industrial activities, in the Central sector, as they exist presently is given below :

A. Banking, Insurance and Investment

Agricultural Refinance Corporation
Deposit Insurance Corporation
Employees' State Insurance Corporation
Industrial Development Bank of India
Industrial Finance Corporation of India
Life Insurance Corporation of India
Reserve Bank of India
State Bank of India
Unit Trust of India

B. Air Transport

Air India
Indian Airlines Corporation

C. Commercial and Trading

Food Corporation of India

D. Promotional and Developmental

Central Warehousing Corporation
Oil and Natural Gas Commission

E. Industrial

Damodar Vally Corporation

Government Companies

Another form of organization which has quite extensively been adopted in India is to incorporate a public enterprise as a joint stock company under the Companies Act, 1956. The main characteristics of a government company are : (a) it has most of the features of a private limited company; (b) fifty one per cent or more, even the whole, of its capital must be owned by the State; (c) all the directors, or a majority of them, are appointed by the government depending upon the extent to which private capital is participating in the enterprise; (d) it is a body corporate, created under a general law, viz., the Companies

[3]Khera, S.S., "Legal and Organizational Forms of Public Enterprise" in the *Organisation and Administration of Public Enterprises.* New York ; United Nations, 1968, p. 153.

Act, 1956; (e) it can sue and be sued, enter into contract, and acquire property in its own name; (f) unlike a statutory corporation, it is created by an executive decision of the government without Parliament's specific approval having been obtained, and its Memorandum and Articles of Association, though conforming to the requirements of the Companies Act, are drawn up and are revisable by the executive government; (g) its funds are obtained from the government and, in some cases, from private shareholders, and through revenues derived from the sale of its goods and services; (h) it is generally exempt from the personnel, budget, accounting and audit laws and procedures applicable to government departments; and (i) its employees, excluding the deputationists, are not civil servants.

"There are several advantages to this form of organization for public undertakings. It provides considerable flexibility and freedom of action on the part of management, more so especially than direct management of an undertaking by a ministry or a government department. Experience has also shown that a corporation functioning under a special Statute governing it often lacks the managerial flexibility and degree of freedom which is necessary to a commercial enterprise. Where a general law, such as the Companies Act, makes provision for an almost endless variety of different kinds of trading and industrial enterprises, there appears to be built-in flexibility and freedom of movement which are often wanting when the management has a single specific Statute as its point of legal reference. It is also a good thing for a public undertaking conducting business to be a distinctly separate commercial entity from the rest of the governmental administrative apparatus."[4]

As at March 31, 1968, the total number of government companies at work was 241 with a paid-up capital of Rs. 1532 crores. Of these 85 companies were in the Central sector and the remaining 156 in the State sector. The following are the first ten of the government companies in the Central sector :

Bharat Heavy Electricals Limited
Bokaro Steel Limited
Fertilizer Corporation of India Limited
Heavy Electricals (India) Limited
Heavy Engineering Corporation Limited
Hindustan Aeronautics Limited
Hindustan Steel Limited
Indian Oil Corporation Limited
National Coal Development Corporation Limited
Neyveli Lignite Corporation Limited

[4] *Ibid.*, pp. 153-154.

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Principles of Pricing in Public Enterprises

In a mixed economy, where a significant proportion of production activity is controlled by the undertakings in the public sector, the price policy of public enterprises attains a considerable degree of importance. As a matter of fact, the State, exercising control of such enterprises, can influence directly the functioning of a substantial sector of the economy and this affords the public authorities an additional means to pursue their socio-economic objectives. In the underdeveloped economies particularly, where the emergence and growth of public sector forms an important element in the entire process of economic growth, the price policy of public enterprises acquires an added significance.

Generally, the public enterprises are designed to serve certain well defined socio-economic objectives. The objectives thev are expected to serve are usually defined and detailed in their relevant Statutes and accordingly, their price policy has to be determined in the light of such aims and objects. In their actual operations, public enterprises are guided by a combination of commercial and non-commercial elements in varying degrees, and this involves certain important implications. *Firstly*, the public enterprises are designed to serve certain well defined public purposes and as a consequence, a pricing policy pursued by the private enterprise and the principles involved thereunder may not be entirely suitable for the public enterprises. *Secondly*, the nature and extent of socio-economic objectives in relation to public enterprises may not be capable of being defined precisely and may differ in amount and character from one undertaking to another (may be from one country to another). As such no uniform principles can be laid down for price policy in public enterprises. *Thirdly*, the price policy of public enterprises shall also be guided by the degree of monopoly enjoyed by them and the extent of protection they enjoy vis-a-vis foreign competition. *Fourthly*, such a policy shall have to take into consideration the character of the consumers of their end-products and the undertakings which are using their outputs as inputs.

Of the principles of pricing which have generally been advanced in relation to price policy of public enterprises, the most important are: (1) the principle of break-even *or* the principle of 'no-profit no-loss'; (2) the principle of marginal cost of production; (3) the principle of average cost of production; and (4) the principle of making profits. The basic outlines of these approaches are examined in the succeeding paragraphs.

The Principle of Break-even

The traditional argument in respect of the conduct of public enterprises is that such undertakings are meant primarily to serve certain well-defined socio-economic objectives and as such they should be run on 'no-profit no-loss' basis. "The sort of price policy that a public corporation ought to follow can be stated simply in two rules; (1) it should make neither a loss nor a profit after meeting all capital charges; and (2) the prices it charges for different services should correspond to relative costs."[5] Professor Lewis adds that "if the corporation makes a profit or loss it should be required so to adjust its prices as to eliminate the profit or loss."[6] He maintains that the principle, if followed energetically, would avoid under-capitalization or over-capitalization of the undertakings in question and would check inflationary and deflationary tendencies. If, under compulsions of certain socio-economic considerations, it becomes socially desirable to supply a commodity or service at a price below or above the average cost of production, the most desirable method would be to use the mechanism of subsidies or commodity/service taxation and reflect the difference in the budgetary expenditure or receipts.

The principle of break-even suggests therefore that the public enterprise should operate in such a manner that it is able to recover its costs from its revenues and is able to provide for the normal depreciation on equipment and the due replacements of such equipment. A.D. Gorwala suggested the same principle to be adopted by the public enterprises in India. According to him "the general pricing policy should be to fix such a price for the product so as to enable the enterprise to 'break-even' over period of years or taking one year with another" as is sometimes stated. In other words, "taking several years together the enterprise should make neither loss nor profit."[7] "As a general rule public undertakings — while complying with the rule of economic viability, which applies to them also — should refrain from seeking maximum profit and operate directly with a view to promoting the general interest."[8]

Professor Robson on the Principle of Break-even

While formulating the general financial aim of public enterprises on the basis of the principle of break-even, Professor Robson does not agree

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[5]Lewis, W.A., "Price Policy of Public Corporation", in *Problems of Nationalized Industry*, (Ed. William A. Robson). London : George Allen and Unwin, 1952, p. 181.

[6]*Ibid.*, p. 189.

[7]Gorwala, A.D., *Report on the Efficient Conduct of State Enterprises*. New Delhi : Planning Commission, 1954, p. 27.

[8]INRICE Theory Committee, "Price Setting in Public Undertakings", in the *Annals of Collective Economy*, July/September 1962, p. 272.

with the above interpretation of the break-even principle. Though he does not favour a public enterprise to be operated so as to be a source of revenue for the public sector to finance its activities elsewhere, he suggests that adequate surpluses must be earned in order to finance the expansion and development of the undertaking concerned. "While we may agree whole-heartedly with the proposition that publically owned industries should not be run in order to provide a source of revenue for either the national government or for local authorities, this by no means concludes the question. There are other purposes for which a surplus may be required. If a public corporation makes a surplus in the course of its business, it must by law be applied for the purposes of the corporation as defined by Parliament in the relative statute. This means in practice that any excess revenue would ultimately be ploughed back into the undertaking, or be spent on improving the service or quality of goods, in pursuing research or development, reducing prices, increasing wages, or bettering conditions of employment. The normal method of disposing of a new surplus is to place it to reserve. Indeed, the main reason for making a net surplus is to build up the reserve fund."[9]

Ordinarily, retained profits (alongwith the excess of depreciation provision over replacement costs) constitutes an important source of financing the expansion and development of the undertakings in the private sector. Professor Robson had calculated that public companies quoted in the London Stock Exchange Market were able to finance 75 per cent of their investment requirements from retained profits and other internal resources during the quinquinnium 1949-1953. The comparative account for the corporations in the U.S.A. for the same period was put at 64 per cent.[10] Even in India, a bulk of the investment requirements of the non-financial corporate sector is met from to internal resources generated by the corporate sector. There is no reason, therefore, why a similar norm should not be adopted by the public enterprises so as to earn surpluses for the purpose of internal financing of expansion and development. According to Professor Robson, there is "no reason why nationalized industries should not be as free as profit making companies to find as much money for capital development from internal resources as they think fit."[11] He is of the opinion, that "much larger allocations to reserve should be made, whenever possible, in the nationalised industries, in order to enable them to finance a much higher proportion of their capital investment from internal resources. These allocations should be charged against revenue, as required by the

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[9]Robson, William A., *Nationalized Industry and Public Ownership*. London : George Allen and Unwin, 1960, p. 293.

[10]*Ibid.*, pp. 306-807.

[11]*Ibid.*, p. 311.

statutes, in order to preclude unfounded demands for higher wages or lower prices. The allocation of such reserves is in no way incompatible with the obligations of the public corporations about breaking-even, but in order to do so they would have to increase prices."[12]

Normally, according to 'accounting' principles, the depreciation provision is based on the book value of the productive assets, commonly known as 'depreciation provision on historical cost'. A sound policy would, however, be to relate depreciation provision to the replacement cost of the plant and equipment at current prices, and the consumers of the commodity/service produced should be charged for making good fully the real productive resources which are used-up in producing the commodity/service. Such a policy would not be incompatible with the principle of break-even. In the light of the aforesaid, thinking has crystalised in recent years that even based on the principle of break-even, the performance of the public enterprises should be such that not only they are able to meet their normal costs but should also be able to create sufficient, but just sufficient, surplus for adequate replacement of plant and build up reserves for development purposes. Elaborating on the financial and economic obligations of the nationalized industries, the British government remarked :

"The Government consider that the financial objectives of the nationalized undertakings under their Statutes should now in general be interpreted on the following lines :

(a) Surpluses on Revenue Account should be at least sufficient to cover deficits on Revenue Account *over a 5-year period :* in arriving at the surpluses and deficits for each year there should be charged against revenue the items normally so chargeable (including interest, and depreciation on the historical cost basis).

(b) Provision should also be made from revenue for : (i) such an amount as may be necessary to cover the excess of depreciation calculated on replacement cost basis over depreciation calculated on historic cost as in(a) above; (ii) adequate allocations to general reserves which will be available *inter-alia* as a contribution towards their capital development and as a safeguard against premature obsolescence and similar contingencies."[13]

"There are powerful grounds in the national interest for requiring these undertakings to make a substantial contribution towards the

[12] *Ibid.*, p. 318.

[13] *The Financial and Economic Obligations of the Nationalized Industries*, London : Her Majesty's Stationery Office, April 1961, p. 7.

cost of their capital development out of their own earnings, and so reduce their claims upon the nation's savings and the burden on the Exchequer : this is particularly so for those undertakings which are expanding fast and which have relatively large capital needs."[14]

The Principle of Marginal Cost of Production

The principle of marginal cost of production for pricing in the public utilities in a mixed economy was propounded by Professor Hotelling.[15] The principle so as to be applicable to all enterprises (whether public utilities or otherwise) in a socialist economy was advanced by Professor A. P. Lerner.[16] According to the principle, the prices of the commodity/service should be fixed on the basis of the marginal cost of production in order to ensure an optimum allocation and utilization of productive resources resulting in an optimum output.[17] In a perfectly competitive market, where prices are autonomously determined and are beyond the influence of the producers, the output is extended to a point where marginal cost is equal to price as well as the marginal revenue. The protagonists of the marginal-cost prices contend that although perfect competition may be an unreasonable and untenable assumption in the context of public enterprises, nevertheless the norm can ideally be applied to other market structures also.

The principle of marginal cost of production, sometimes known as the 'Hotelling-Lerner' Rule, suffers, however, from the following shortcomings :

Firstly, undertakings operating under the conditions of increasing returns or decreasing costs would be confronted with a situation where average cost of production would be higher than the marginal cost of production. A price which is equal to the marginal cost of production would result in a lesser amount of total revenue than the total cost. Such losses are not regarded, however, as a reason for departing from optimum output as defined by the marginal analysis. The loss arising in this way may be made good either by subsidies financed out of general taxation *or* taxing the commodity/service by an amount equal to the difference between the average cost of production and the marginal cost of production. If the loss is covered by subsidies financed out of general taxation, the

[14] *Ibid.*, p. 8.

[15] Hotelling, H., "The General Welfare in Relation to Problems in Taxation and of Railway and Utility Rates", in the *Econometrica*, July 1938.

[16] Lerner, A.P., "Statistics and Dynamics in Socialist Economics" in the *Economic Journal*, June 1937.

[17] Meade, J.E., "Price and Output Policy of State Enterprises", in the *Economic Journal*, December 1944, pp. 321-328.

users of the commodity/service are likely to gain at the expense of general tax-payers. A subsidy to such enterprises, in addition to leading to a redistribution of income (which may not always be conducive to the general economic welfare) may lead to laxness and inefficient management resulting in a higher cost of production. Moreover, in a mixed economy, if guided by the principle of equity, subsidies are also to be given to enterprises in the private sector as may be enjoying the conditions of increasing returns or decreasing costs, the amount of total subsidy may come up to some fantastic figures.[18] On the other hand if the commodity/service is taxed, it would make the price of the commodity/service equal to the average cost of production and as such would be counter to the very concept of marginal cost pricing.

Secondly, the argument that the principle of marginal cost pricing leads to optimum allocation of resources loses its validity once we drop the assumption of the existence of a perfectly competitive market. Moreover, in a mixed economy, if the principle of marginal pricing is applied for the pricing of the products of public enterprises, but, in the private sector, under conditions of imperfect competition, the criterion of profit-maximisation is applied, the discriminatory application of the rule is unlikely to lead to ideal output. Further, marginal cost pricing fails to provide any investment criterion.

Thirdly, in the case of monopolies operating under the conditions of increasing costs, situations which are quite possible in the case of public enterprises, marginal cost pricing would lead to huge profits—not always an objective with the public enterprises.

Fourthly, the marginal cost is not capable of being assessed accurately because of the lumpiness of production in the modern industrial set-up. The difficulties would still be more where multiple products/services are being produced.

Fifthly, if the principle of the marginal cost of production is faithfully followed, fluctuations in demand and supply would result in a significant amount of fluctuations in the marginal cost and hence prices. Introduction of time periods, of uncertainty, and changing characters of the market situations makes the problem still more complex. "Irregular and unforeseeable fluctuations are, however, a nuisance.... .This is one of the reasens why uniform prices have been enforced by the law on railways and taxicabs, and by customs on department stores, hotels, professional men, and in many other fields."[19]

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[18] Crossland, C.A.R., "Prices and Costs in Nationalized Undertakings", in the *Oxford Economic Papers*, (New Series), No. 1, January 1950, p. 52; and *Coase*, R.H., "Price and Output Policy of State Enterprise —A Comment", in the *Economic Journal*, April 1945, p. 178.

[19] Lewis, W.A., *Overhead Costs*. London : George Allen and Unwin, 1949, p. 18.

To sum up, the principle of marginal cost pricing does not provide a correct criterion for optimum allocation of productive resources, for emerging investment policies, for efficient conduct of public enterprises, and for guidance under imperfectly competitive conditions. "The general case against marginal cost pricing is overwhelming. All arguments, even the dubious purely theoretical ideal output arguments, are against it."[20]

The Principle of Average Cost of Production

'The prices of the commodity/service supplied by the public enterprise should be determined with reference to the principle of average cost of production', is commended for the following reasons:[21]

(*a*) the public sector undertakings are expected primarily to meet needs, that is, to provide an optimum volume of supplies cheaply without seeking any profit;

(*b*) every purchaser of the commodity/service pays the average cost of production of the commodity/service in question rather than paying the additional cost of producing the marginal units;

(*c*) average cost pricing means absence of exploitation;

(*d*) average cost pricing acts as a reliable criterion for determining the investment decisions; and

(*e*) the principle of average cost assures full recovery of the entire cost of production and secures thereby the viability and autonomy of the undertaking.

The theory suffers, however, from a number of limitations.

Firstly, the determination of average costs is not as practicable as it appears from the accounting point of view. "The task of correctly allocating cost elements is fraught with theoretical difficulties of principle, which cannot be overcome by any degree of improvement of the accounting systems of individual economic units and the economy as a whole."[22]

Secondly, the problem of calculating the 'capital consumption allowance' or the 'depreciation allowance' and its appropriate distribution while determining the average cost of production has to be solved in a satisfactory manner. Whether depreciation should be calculated on the basis of book value of the capital assets, *or*, on the basis of replacement cost, *or*, a liberal financial prudence is to be followed in order to make suffi-

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[20]Little, I.M.D., *A Critique of Welfare Economics*. Oxford: Clarendon Press, 1957, p. 194.

[21]Thiemeyer, Theodor, "Theories Concerning the Problem of Price Setting in Public Undertakings", *Annals of Collective Economy*, July/September 1962, p. 263.

[22]INRICE Theory Committee, *op.cit.*, p. 273.

cient allowances for technological advancements, is a matter which has attracted a considerable amount of controversy.

Thirdly, the problem of the measurement of social costs—tangible and intangible—involved in the cost of production poses another difficulty for accurately determining the average cost of production. Similarly, if allowance is to be made for the social benefits, the problem becomes still more complex.

Fourthly, the average cost pricing may lead to excess capacity or undue restrictions on investments where potentialities exist, especially in industries/undertakings enjoying economies of large scale production or increasing returns. The criterion may hide the inefficiency of an enterprise and force the consumers to pay the full costs of an obsolete high cost plant, by removing any incentive for innovation.

Price Policy Aimed at Earning Profits

The growing dimension of the public sector in the underdeveloped economies is the manifestation of the growth and development of a significantly growing number of public enterprises. In such economies the propensity to save being lower, the effort at accelerating economic development is hindered by the inadequacy of investible resources. Without entering into the details of the alternative methods of resource mobilization in an underdeveloped economy, it may be pointed out that both taxation and borrowings have their limits. Taxation used as a mobiliser of investible resources cannot be pushed very far because of the thin tax-absorption capacity of these economies. Similarly, borrowings for financing the Plan programmes may not attract sufficient amounts of investible funds because of the very low propensity to save in the underdeveloped economies, underdeveloped capital and money markets, and other such inhibitors. Deficit financing, though often resorted to, can be potentially dangerous for growth with stability if pushed excessively.

The fact that in such economies the emphasis is on a predominant role the public investments and the public sector has to play in accelerating the pace of economic growth, for ideological reasons or as a practical expedient, or both, it becomes both desirable and necessary that the public enterprises should adopt pricing policy in order to earn sufficient profits to meet the financial requirements arising out of their expansions and development. Moreover, these profits should allow for reasonable returns on investments put up by the Exchequer so as to contribute to the general revenues of the State. "In certain cases where the State has made substantial investments, a policy of regulating prices so as to secure an adequate return on the capital invested is not only unobjectionable but may, indeed, be desirable. This is particularly so in the conditions of economically underdeveloped countries where public enterprise itself, fostering at State expense, may in turn play a role in financing the country's development."[23]

In this connection, Professor V.K.R.V. Rao observes that "the price policy should be such as to promote the growth of national income and the rate of this growth......Public enterprises must make profits and the larger the share of public enterprises in all enterprises, the greater is the need for their making profits. Profits constitute the surplus available for savings and investment on the one hand and contribution to national social welfare programme on the other; and if public enterprises do not make profits the national surplus available for stepping up the rate of investment and the increase of social welfare will suffer a corresponding reduction.......Hence the need for giving up the irrational belief that public enterprises should, by definition, be run on a no profit basis."[24] According to Professor J.K. Galbraith : "If I had to lay down a measure for performance of publicly-owned corporations in the developing country, it would be the earnings that it is able to put into its own expansion...... The most successful firm would be the one which by its efficiency and drive finds the earnings that allow it the greatest growth."[25]

The chief merit of such a price policy by the public enterprises is that it is an economical and convenient way of resource mobilization for economic development. "The case for resource mobilisation through the price policy of public enterprises also rests on the fact that it is an administratively very convenient and politically very feasible method of raising very substantial resources for the public sector. It does not involve any administrative expenditure as the mobilisation of resources through the instrument of taxation does. The earning of surpluses by public undertakings is also necessary in order to realize the capital expenditure incurred in the establishment of such undertakings when a substantial portion of such expenditure may have been financed by internal and external loans."[26]

In underdeveloped economies, notwithstanding the sizeable growth of the public sector with successive efforts towards economic growth initiated and sustained by the government, a change is likely to take place in the compositional character of the public sector. Instead of

[23]Government of India, *Report of the Taxation Enquiry Commission*, 1953-54, Vol. I. New Delhi, 1955, p.200.

[24]Rao, V.K.R.V., "The Public Sector in India", in the *Pricing, Labour and Efficiency in Public Sector* (Ed. V.V. Ramanadham). Hyderabad : Osmania University, 1962, p. 3.

[25]Address on "Public Administration and the Public Corporation" at the Indian Institute of Public Administration, New Delhi on August 25, 1961.

[26]Tripathy, R.N., *Public Finance in Underdeveloped Countries*. Calcutta : The World Press, 1964, p. 260.

public sector being confined to the development of public utilities and social overheads like irrigation and power, transport, education, health, etc., large scale expansion of industrial and commercial enterprises may also take place in the developmental process of an economy. The public sector actually becomes a partner with the private sector for the fuller exploitation of industrial and commercial potentialities of the economy. The economic motive of the pricing in the private sector usually is profit maximization and there is no reason why should not the public sector industrial and commercial enterprises adopt the same consideration in their pricing policy in order to mobilize the investible surpluses.

Moreover, if the expanding socialist sector is to attain commanding heights in the industrialization of the economy and has, therefore, to generate ultimately, a substantial portion of the national income, such an important and dominating sector logically cannot be run on the principle of 'no-profit no-loss'. Public enterprises which constitute a significant sector of the national economy, if run on 'no-profit no-loss' criterion, would disturb the pattern of the revenues of the State. A good source of tax receipts which would normally come from the profits of public enterprises would have dried up and the undertakings who suffer losses would draw upon the Exchequer so as to eat into the resources mobilized otherwise. If such a drying up of the source of revenue to the government is to be avoided, it becomes necessary either to devise an appropriate system of taxation on public enterprises or to run them in order to earn profits. Thus the changing character of the public sector, quantitatively as well as qualitatively, would demand that a departure should be made from the traditional principle of 'no-profit no-loss'.

It has been observed "that private enterprise could be relied upon to operate in all fields in which profits could be made in more highly developed countries, but not to the same extent in underdeveloped countries. When private enterprise failed to operate in a profit-making field, it was appropriate for publically financed enterprise to fill the gap, profit could be made available for further development. Furthermore, a publically owned profit making enterprise might be carried on in underdeveloped countries in order to serve as a yardstick to measure the efficiency, tax-paying capacity and prices of private enterprise. Government enterprises in profit-making fields might also put the public authorities in closer touch with economic realities and thus better enable them to control the process of development, formulate development programmes and improve economic policies generally."[27]

Over and above the above-mentioned justification for running the

[27]United Nations, *Domestic Financing of Economic Development*, New York, 1950, p. 50.

public enterprises on a profit criterion, the concept has an added importance in the context of an economy being transformed into a socialist set-up. "The theory of 'no-profit no-loss' in public enterprises is particularly inconsistent with a socialist economy, and if pursued in a mixed economy it will hamper the evolution of the mixed economy into a socialist society. The sooner, therefore, the theory of 'no-profit no-loss' in public enterprises is given up and the policy accepted of having a price and profit policy for public enterprises such as will make the State increasingly reliant on its own resources (as distinguished from taxing the personal incomes of its citizens), the quicker will be the evolution of a socialist society."[28] Socialist industrialization depends primarily on the profitability of public enterprises which is a less cumbersome source of resource mobilization for the public sector programmes.

3

Criterion for Profit-Making in Public Enterprises

In the context of underdeveloped economies, it is now generally agreed that the public enterprises should be run so as to aim at earning surpluses to make a substantial contribution for their own development, besides making a significant contribution to the national Exchequer for financing development elsewhere. But such a policy of profit-maximisation would, in practice, be subject to certain important qualifications. *Firstly*, in a mixed economy, where in several fields public and private undertakings are in competition, the prices of the commodities/services supplied by public undertakings would be competitively determined as under duopolistic or oligopolistic market structures. This would limit the powers of the public authorities to maximise profits or to achieve the desired targets of profits. *Secondly*, although the ability of the public undertakings to earn profits, where they operate as monopolies or quasi-monopolies, is enhanced considerably, a policy of profit-maximisation may run counter to certain other important social objectives. The commodity/service produced may be of basic or essential character, and it may be in the public interest or in the interest of growth that such commodities/services are sold deliberately at subsidised prices. *Thirdly*, in certain cases, the products of the public undertakings may be purchased and consumed by other public undertakings/departments, e.g., the products of Hindustan Aeronautics, Indian Telephone Industries, Heavy Electricals (India),

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[28]Rao, V.K.R.V., "Prices, Income, Wages and Profits in a Socialist Society" in the All India Congress Committee, *Ooty Seminar Papers*. New Delhi, 1959, p. 176.

Bharat Heavy Electricals, National Coal Development Corporation, etc. Profits earned by such undertakings would mean higher expenditures on the part of other public undertakings/departments with a built-in offsetting effect. In such cases the 'cost-plus' principle is applied generally. *Fourthly*, the commodities/services produced by the public undertakings may be consumed by the vulnerable sections of the society and as such it may not be publically desirable and politically feasible to earn profits on such commodities/services.

In the context of the aforesaid, for a realistic determination of a pricing policy, public sector undertakings in underdeveloped economies can conveniently be divided into the following categories:

(1) public utility enterprises;
(2) undertakings which have monopoly position in the market; and
(3) undertakings which compete with the private sector enetrprises in the market.

Price policy usually followed in the public utilities is based on the principle of break-even which takes into consideration the needs of the enterprise in respect of depreciation and replacement allowances in addition to the resource requirements arising out of expansion and development programmes. "In the case of underdeveloped countries, such enterprises may not be made a source of revenue to the public authorities in the initial stages of development in order to encourage demand and widen the market, but they should not be prevented from earning a surplus to be made available for capital formation over the long period."[29]

As regards public monopolies, other than public utilities, a number of criteria is generally suggested for their pricing policies : (1) the criterion of growth; (2) the criterion of optimum allocation of productive resources; (3) the criterion of maximum utilisation of the existing stock of capital; (4) the stimulation of certain products at the cost of others; (5) provision of the maximum possible incentives for promotion of efficiency. These criteria are often competing with each other, rather may sometimes be conflicting, and as a consequence the actual policy decisions may present a sort of compromise aiming at the achievement of the declared socio-economic goals.

Viewed from the criterion of growth a price policy should be designed in such a way that the public sector enterprises should produce sufficient amounts of investible surpluses for financing the development programmes in the public sector. "If the enterprise makes no profits, it cannot help finance its own expansion. Therefore, on the assumption that it is unable to raise money by issuing securities to the public, the whole of its capital

[29]Tripathy, R.N., *op.cit.*, p. 263.

supplies must come from the government. The latter, in its turn, will have to raise the necessary funds by increasing taxation, which may be difficult or by inducing inflation which is always dangerous. Moreover, even if capital can be raised from the public, it is not necessarily desirable to have recourse to this method, the effect of which may be to redistribute income in favour of the wealthier members of the community. Admittedly if the enterprise makes profits and uses them for self-financing, or if the State mops them up and invests them elsewhere, it is the consumer who pays, and there is undoubtedly some inequity. But it is also the consumer who, in the long run, pays for loan-financing and ultimately pays more. Apart from this, and much more importantly, it may be desirable, from the point of view of planned, coherent economic development, not to pass on the benefit, in the form of low prices, to the consumer, for the individual consumer is not inevitably induced thereby to save more, and the industrial consumer will not necessarily use the resultant higher profits of his enterprise to the best national advantage."[30]

In case the criterion of optimum allocation of productive resources is to be followed, pricing related to the marginal cost of production seems to be most appropriate. "One may choose the rate of growth criterion, or one may choose the criterion of optimum allocation of resources. From the point of view of the latter criterion, the economist will not only rule out the element of monopoly profit, but would in certain cases recommend a price policy which involves loss to the enterprise. Where the overhead cost is high, as in major irrigation, and where the average cost is a decreasing function of output, the criterion of optimum allocation would dictate maintenance of a price which is below average cost. On the whole, since the majority of industries in an economy are supposed to conform to the principle of constant returns to scale, the near approximation to optimum allocation is provided by cost-price equation which is the competitive criterion. This is a perfectly legitimate criterion to adopt even under socialism."[31]

In a developing economy which is set upon attainment of a rate of growth which is distinctly higher than that warranted by normal savings in such an economy, and in which the public sector has taken upon itself to give a push to the growth, it may become expedient to deviate from the criterion of optimum allocation of resources and to aim at growing surpluses from the public enterprises with a view to mobilize the maximum resources for development purposes. It may be pointed out, however,

[30]Hanson, A H., *Public Enterprise and Economic Development*. London : Routledge and Kegan Paul, 1959, pp. 436-437.

[31]Das Gupta, A.K., 'No Profit, No Loss', *The Economic Weekly*, Special Number, July 1959, p. 974.

that, under certain circumstances, pricing based on maximisation of surplus may not be justifiable even from the criterion of economic growth. In cases where the end-products of the public enterprises are capital goods, metals or other intermediate commodities, prices of such goods based on the maxim of profit-maximization may increase the cost of development in industries where such goods are used as inputs, which in turn may check the growth of the industry in general. The same argument can be advanced, with equal force, in respect of irrigation, power and transport undertakings operating as public monopolies. The situation assumes particular relevance in a developing economy operating within the framework of a mixed economy, and where the public sector occupies the basic or strategic points of several industrial complementries.

Notwithstanding all this, viewed from the point of resource mobilization, and this is a point of utmost importance in an underdeveloped economy, a price policy aimed at realization of substantial surpluses, must take precedence over other criteria. Other considerations, in this context, may be relegated to subsidiary and unimportant position.

The question of an appropriate price policy to be adopted by public enterprises, operating under monopolistic and semi-monopolistic conditions, was examined by the Taxation Enquiry Commission. It was observed that "normally such undertakings should operate on the basis of meeting their full costs of production including adequate depreciation provision (taking account of higher replacement costs) and a reasonable return on capital and, as a rule, subsidisation of prices should be avoided. Where revenue requirements necessitate the levy of taxes on commodities or services which are as 'basic' or 'essential' as those which are the products of State enterprise......the State should not regard itself as being precluded from using its monopolistic and semi-monopolistic power to secure larger revenues by an appropriate price policy."[32] The Commission was of the opinion, however, that with a view to encourage demand and widen the market so as to make the enterprise profitable over a long period, it may be desirable, in the early phase of development, to keep prices low, even if this involved incurring losses. This would particularly be so in the case of public utilities like electricity undertakings where usually promotional pricing policies are adopted in the early phases in order to reap best long-run results. For other semi-monopolistic undertakings producing basic commodities like pesticides, fertilisers, ship-building, etc., subsidies may be recommended, for certain initial periods, as a matter of policy.

As an overall policy, however, even the Commission was of the view

[32]Government of India, *Report of the Taxation Enquiry Commission*, Vol. I. New Delhi, 1953-54, p. 200.

that in cases where the State has incurred large amounts of investment, a policy of regulating prices with a view to secure an adequate return on the capital invested is not only unobjectionable, but also desirable. This would particularly be so in underdeveloped economies, where the public enterprise, itself fostered at State expense, is expected to play a role in financing economic development. "There is need for greater recognition on the part of public opinion of the principle of obtaining for the State a share of the higher output made possible by State investment in order that it may assist further investment and thereby accelerate economic development."[33]

Commenting upon the argument, generally advanced, that the public undertakings should primarily be guided by public interest rather than profit motive, the Commission observed: "In the public sector profit is not necessarily inconsistent with public purpose, on the other hand, it may itself constitute a public purpose, even if it remains secondary. In certain circumstances, as in the case of fiscal monopolies avowedly established for the purpose of maximizing revenue, it forms the primary objective, though it is sometimes combined with a social objective in the form of a regulatory or restrictive function. In other public enterprises, the first objective, of course, is maximum service combined with maximum efficiency with a view to the widest extension of social welfare and economic development. Consistent with these, a certain measure of profit, and in some circumstances, even a significant amount of profit, should not be precluded under the broad principles which regulate pricing policy."[34]

4

Certain Limitations

Price policy in public enterprise, when used as a means for mobilizing substantial surpluses for further financing of public sector investments may, however, be subject to certain disadvantages:

Firstly, this is a method of resource mobilization which is convenient administratively and practicable politically, and as such the State may have the temptation of exploiting its monopolistic or semi-monopolistic position by raising the prices arbitrarily. In a parliamentary democracy, however, where the State is to keep social considerations and the climate of public opinion in the forefront, such arbitrarily increased prices may not be translated into reality.

[33] *Ibid.*, p. 201.
[34] *Ibid.*, p. 202.

Secondly, an argument is advanced sometimes that "the element of profit contained in the prices of public enterprises is a concealed form of commodity taxation, and as such, this form of taxation is bound to be regressive. Thus it would tend to exaggerate the regressiveness of a tax structure in a developing economy. But in such an economy, the need for mobilization of maximum investible surplus necessitates that the principle of equity in public finance may have to be relegated to a subordinate position, and as a result, the tax structure inevitably becomes regressive in character."[35] Moreover, whether the profit element is regressive in character or not, depends upon what sections of the society the final incidence of the public sector pricing falls.

Thirdly, in an underdeveloped economy, the most real and serious danger inherent in the price policy aiming at generation of substantial surpluses, especially when the public enterprise is in a monopolistic or semi-monopolistic position, is that the enterprise may be running inefficiently and such an inefficiency may be concealed in putting up prices of the products. There cannot be two opinions on the need that it must be ensured that the public enterprise is run on high standards of performance and efficiency. In order to ensure that there must be some independent organization to keep a watch on such undertakings.

Fourthly, generation of substantial surpluses as a test of efficiency of the public enterprise must take into consideration the social costs involved as such.

Fifthly, the norm should be greater production and lower margin of profit, rather than restricted production and a higher margin of profit as usually happens in case of monopolies. The prime measure of efficiency as breaking-even, or slightly more than even, is at the greatest possible aggregate of production.[36]

Sixthly, granted that public enterprises in the underdeveloped economies must earn a substantial margin of investible surpluses for generating resources for further development, it must be borne in mind that the element of profit concealed in the prices of the products of public enterprises cannot be viewed on a uniform basis. It would, necessarily, differ from enterprise to enterprise depending upon the nature of the commodity produced and the importance of the industries, using these products as inputs, in the developmental programmes.

According to Professor W.A. Lewis, the price policy of every public corporation should be made subject to the scrutiny by an independent

[35]Tripathy, R.N., *op.cit.*, pp. 267-68.

[36]Florence, Sargent, and Walker, Gilbert, "Efficiency under Nationalisation and its Measurement", in the *Problems of Nationalized Industry*, (Ed. William A. Robson), *op.cit.*, p. 196.

tribunal.[37] Professor William A. Robson remarks that "there is much to be said in favour of a form where the arguments for and against proposals to alter the prices of goods and services produced by the nationalized industries can be ventilated in public before an objective and expert tribunal provided that the evidence and arguments are not confined to the formal or legal aspects but are directed to the basic questions concerning the management of the industry."[38] Professor A. H. Hanson maintains, however, that in case of fixation of rates and prices by public enterprises, we are not primarily concerned with the dispensing of even-handed justice between producer and consumer for which a tribunal may be well suited, but with an aspect of economic planning. Policy, not justice, is the criterion, and policy cannot be decided by the process of weighing the arguments and counter-arguments presented by the variety of interested parties.[39] Professor Hanson has conceded, however, that judicial types of specialized bodies having adequate expertise to inquire into price policies and to make recommendations may have some use, a price policy connot be imposed on a public enterprise; it has to emerge from consideration of the facts and the most important of those facts are the costing data and market forecasts produced by the enterprise itself.[40]

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[37]Lewis, W.A., "Price Policy of Public Corporations", in *Problems of Nationalized Industry*, (Ed. William A. Robson), *op.cit.*, p. 193.

[38]Robson, William A., *Nationalised Industry and Public Ownership, op.cit.*, p. 271.

[39]Hanson, A.H., *op.cit.*, p. 439.

[40]*Ibid.*, pp. 439-440.

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APPENDIX

A NOTE ON PERFORMANCE BUDGETING

An important characteristic of planning for economic development, as adopted by most of the underdeveloped economies, has been the dominant role assigned to the public investments and the consequent importance accorded to the public sector. The governments of these countries have assumed not only a centralized direction of resource mobilization and their use, but also have undertaken significant amount of entrepreneurial avocations, which have led to a logical development of public sector becoming a dominant factor in the process of economic development. This development has brought in its wake many important structural changes in the economic and financial administration in these countries.

These structural changes have brought alongwith institutional adjustments in the organization and conduct of public sector programmes and activities. The entrepreneurial functions and activities in the public sector are mostly excluded from the conventional budgetary framework and are entrusted to autonomous corporations/joint stock companies. In a number of instances, however, the government budget includes, in addition to normal administrative programmes and activities, certain entrepreneurial activities commonly known as departmental undertakings. "The institutional seperation of enterprise activities rests partly on management considerations; but this exphasis on management aspects, sound as it is, is rarely found in its application to public sector transactions included in a budget. A plan is essentially a blue-print for action while budgetary activity is mainly operational in nature. It would be, therefore, only logical to expect that management considerations should be of eminent importance in budgeting, and that the budget should be so devised as to highlight the truely operational character, both physical and financial, of any given programme. Such is, however, not the experience in many developing countries. As a result, the operational character of a government budget and its links with planning are largely obscured."[1]

DEVELOPMENT OF THE MANAGEMENT APPROACH IN BUDGETING

The system of conventional budgeting, which is in vogue in the majority of the countries, conceives an emphasis on financial aspects of governmental operations. "The financial accountability to the legislature is usually the overriding consideration and this permeats the entire budgetary process. Emphasis is placed mainly on the observance of appropriation limits. Moreover, the object-cum-organizational classification of expenditures in the budget does not enable identification of programmes

[1]United Nations, Department of Economic and Social Affairs, *A Manual for Programme and Performance Budgeting*. New York, 1965, p. 1.

or projects and, furthermore, is not related to the cost of major inputs or the work performed. In other words, the system of budgeting does not provide information on what a government is actually doing and what it gets for the money spent. Of course, it may be possible to compile such information from departmental reports or other supplementary documents, but in many cases this information cannot be linked directly with financial data as they appear in a budget or in the accounts because it does not constitute a basis for budget management. The absence of pertinent information of this type reduces the usefulness of this budgetary approach even for purposes of legislative review and appropriation. The sanctions resulting from this process then tend to be accorded to policy objectives that are not explicit in the budget."[2]

The need, development, adoption and use of performance budgeting have developed, therefore, essentially in the context of affecting corrections in this situation. The primary consideration was to highlight management aspects in the budgetary framework and in so doing to bring out the most significant economic, financial and physical aspects of the budgetary activity.

The concept of performance budgeting has developed in the U.S.A. and has been given its most rigorous application in that country. Although a programme based budget was in vogue, in different forms and details, in some metropolitan centres and a few States in the U.S.A., the concept as it is understood now got a major recognition after the first Hoover Commission's Report in 1949. The Commission, recognizing that the most important aspect in budgeting is the performance in respect of the work to be done or the services to be rendered and the cost involvement of such work/service, recommended that "the whole budgetary concept of the Federal Government should be refashioned by the adoption of a budget based upon functions, activities and projects"[3] and this was designated by the Commission as a 'performance budget'.

This recommendation was supplemented by the proposals put forward by A.E. Buck in the Commission's Task Force Report. It was stated : "A programme or performance budget should be substituted for the present budget, thus presenting in a document of much briefer compass the government's expenditure requirements in terms of services, activities, and work projects rather than in terms of the things bought. Such a budget would not detract from congressional responsibility and should greatly improve and expedite committee consideration."[4]

Following the Commission's recommendations, the Federal Government of the U.S.A. decided to formulate its budget on a performance basis since 1951. The importance of the concept was further stressed in the second Hoover Commission's Report in 1955. Substantial progress has been made in the U.S.A. since then and quite recently, a few other developing countries have either adopted this technique or are in the process of considering its introduction.

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[2]*Ibid.*

[3]Commission on Organization of the Executive Branch of the Government, *Budgeting and Accounting*. Washington, 1949, p. 8.

[4]Task Force Report, *Fiscal, Budgeting and Accounting Activities*. Washington, 1949, p. 43.

It may be added here that some distinction has been made in the past between a programme budget and a performance budget, though the Hoover Commission did not seem to view them as different concepts. "There is no precise definition for performance budgeting; it has come to mean something different in every jurisdiction which puts it into operation. In particular, there has been a tendency to make programme budget and performance budget synonymous terms, and this has contributed a good deal to the terminological confusion......In an attempt to clarify what is meant here by programme and performance, definitions will precede organizational and hierarch l lines. For present purposes, programme will be defined in relation to a higher level of organization than performance. A programme embraces a number of performance units......Programme and performance may also be distinguished according to their time demension. Budgeting programmes are inherently forward-looking, a projection of the economic and social policies of a government. Performance must be based on the past — on the record of prior accomplishment. In the preparation of budget estimates, programme determinations should precede and set the framework in which the me asurement of performance can be undertaken."[5]

Quite recently, a United Nations Manual on Programme and Performance Budgeting has made a useful distinction between programme budgeting and performance budgeting. "In programme budgeting, the principal emphasis is on a budget classification in which functions, programmes, and their sub-divisions are established for each agency, and these are related to accurate and meaningful financial data. Performance budgeting involves the development of more refined management tools, such as unit costs, work measurement, and performance standards. Of course, the measurement of work, both in a physical and financial sense, presumes an already formulated set of work units which can be derived only when programmes and their sub-divisions are first established. In this case, performance budgeting is an all-inclusive concept embodying programme formulation as well as measurement of the performance of work in the accomplishment of programme objectives."[6]

It may be mentioned that quite recently, a new programme budget (Planning-Programming-Budgeting System) has been developed in the U.S.A., the purpose of which is to provide for more and better information for decision-makers at all levels of government. It seeks to focus attention on alternative means to achieve carefully defined goals, specifying the full costs and benefits of each alternative, etc. Its special feature is the concept of long-range planning and programming which is brought into the whole process of budget making for the first time.

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The Concept of Performance Budgeting

Performance budgeting, as is generally understood, is essentially a technique of presenting government operations in terms of functions,

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[5]Burkhead, Jesse, *Government Budgeting*. New York: John Wiley and Sons, 1956, p. 139.

[6]United Nations, *op.cit.*, p. 3.

programmes, activities and projects. Through such a meaningful classification of transactions, government activities are sought to be identified in the budget in financial and physical terms so that a proper relationship between inputs and outputs could be established and performance assessed in relation to costs.

The focus in a performance budget is basically different from that in the conventional budgets. The two approaches differ in their scope and context. *Firstly*, under the performance budgeting, emphasis is shifted from the budget as a means of accomplishment to the accomplishments themselves. It concerns itself primarily with the objectives aimed at by the government rather than on the outlays incurred on several projects. An important aspect of the technique of performance budgeting is the precise detailment of the job to be performed or services to be rendered and a realistic estimate of what that job or service will cost. *Secondly*, a performance budget is prepared in terms of functional categories and their sub-division into programmes, activities and projects rather than being prepared in terms of organizational units and the objects of expenditure. The object classification shows *what* government purchases but not *why*; accordingly, it does not show the nature of governmental programmes, or accomplishments under these programmes."[7] *Thirdly*, a performance budget prepared in terms of costs and results facilitates management control by bringing out the programmes and accomplishments in financial and physical terms closely interwoven into one comprehensive document.

The technique of performance budgeting, it may be emphasised, divides the whole gamut of governmental operations into functions, programmes, and activities/projects. A function represents a major division of the total efforts of the government such as Education, Health, Agriculture, Industry, etc. Programmes are broad categories within a function that identify the end-roducts or accomplishments towards the fulfilment of the objectives of a function. They broadly reflect the responsibilities of major organisational units of the government. Activities constitute the collection of homogenous types of work in a programme with a purpose to contribute towards the accomplishment of the programmes. The term project is generally used to distinguish such activities as are of a capital nature. For example, education is a function, university education a programme, training of university teachers an activity, and the construction of buildings, equipping the laboratories, a project.

The introduction of a system of performance budgeting involves three basic steps : (a) establishment of meaningful programmes and activities for each function entrusted to an organization or an agency in order to show precisely the work objectives of various agencies; (b) adoption of a system of accounting and financial management in accordance with the aforesaid classification; and (c) determination of suitable norms, yardsticks, work-units of performance and unit costs, wherever possible, under each programme and activity for reporting and evaluation. Thus, "a performance budget is one which presents the purposes and objectives for which funds are required, the costs of programmes proposed for achieving those objectives, and quantitative data measuring the accomplishments

[7]Burkhead, Jesse, *op.cit.*, p. 133.

and work performed under each programme."[8]

The main objects sought to be achieved by the performance budgeting are :

(a) to coordinate the physical and financial aspects of every programme or activity;

(b) to improve budget formulation, review and decision-making at all levels 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 longterm objectives as envisaged in a development Plan; and

(f) to integrate the annual budgets and development Plans.

In a planned economy, where the public sector outlays constitute a major step towards accelerating the tempo of economic growth, the technique of performance budgeting has its advantages in as much as it serves to bring together the financial and physical implications of each programme, facilitating thereby better programming, decision-making, review of the progress and control for the management, and for a more precise, purposeful and intelligible presentation of government activities to the legislature and the electorate.

PHASES OF PERFORMANCE BUDGETING

The process of performance budgeting involves four broad stages : (1) planning or establishing performance objectives; (2) estimating or determining the quantum of physical resources, like personnel, materials, services, facilities, etc., in order to accomplish these objectives, and the amount of financial resources involved in that; (3) reviewing or ascertaining that the basic objective, resource requirements, and resource availabilities are clear and accurate and conform to overall guides and limits; and (4) operating or accomplishing approved objectives within the appropriations voted by the legislature.

PRE-REQUISITES OF PERFORMANCE BUDGETING

Important pre-requisites for the introduction and operation of performance budgeting are that, as a *first* step, it is desirable to emphasise the programme formulation aspect and to establish a clearly defined and meaningful pattern of organizational responsibilities. In doing so, the budget classification could be closely related to projects included in a development Plan. The *next* logical step would be to bring the system of accounting and financial management into line with budget classification. "In the early stages, emphasis could be placed on planning and on providing prompt financial and related information for use in performance reporting so as to enable a comparison of actual results with original plans. As progress is made towards these objectives, the introduction of accrual accounting and the solution of more complicated accounting problems might be considered. Accrual or cost accounting could be applied either to all types of programmes or to such operations

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[8] *Ibid.*

as commercial or industrial activities."[9] The *third* step consists of the introduction of a system of measuring physical progress and performance. This would depend largely on the availability of relevant statistical data. Each programme would present its own problems in terms of determining proper units of measure and meaningful indicators of performance. *Fourthly*, the system of performance budgeting, because of its significant role in the management of governmental operations, demands specially qualified personnel for its successful operation. "The most important consequence of performance budgeting is that it increases the responsibility and accountability of management......The performance budget enhances the role of management, but at a price—budgeting may no longer be treated as a peripheral assignment, but is now at the centre of management responsibility. This should lead to an improvement in the quality and quantity of budgeting at the level of operations."[10] "In its ultimate application, this approach involves a sound budgetary operation, financial discipline, skilled and responsible manpower both for budget formulation and execution, a frequent and efficient system of recording and reporting financial and physical data, and close coordination between various governmental agencies and the central budget agency."[11]

The technique of performance budgeting suffers, however, from certain limitations :

Firstly, it is sometimes contended that the performance budgeting involves only a quantitative and financial evaluation of programmes and activities. It does not facilitate qualitative evaluation. This limitation is not, however, peculiar to this technique as no budgetary technique is capable of making qualitative evaluation which must depend on certain other appropriate devices.

Secondly, it is claimed that the usefulness of the technique is somewhat limited in the case of activities that are not subject to measurement in any precise manner, such as research, law and order, defence, etc. It is true that the technique may not be as effective as in outlays on physical programmes, but even in such subjective areas, suitable norms can be developed to explain performance in a meaningful manner.

Thirdly, the success of performance budgeting depends upon well-organised departments and agencies identifiable with programmes and activities. In practice, however, precise categories of functions and programmes corresponding to organizational units are rather difficult to achieve. It is argued on the other hand that a synchronisation of functions and programmes with organisations though desirable in the long run, is neither a pre-condition to nor an essential ingredient of a performance budgeting system.

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[9]United Nations, *op.cit.*, p. 3.

[10]Burkhead, Jesse, *op.cit.*, p. 155.

[11]United Nations, *op.cit.*, p. 3.

3

Desirability and Scope of Performance Budgeting in India[12]

The pattern of existing budgetary system in India (hereafter referred to as the 'conventional budget') has been designed mainly to ensure legislative accountability and accounting scrutiny. Its primary object is to ensure that the moneys are raised and disbursements made by the public authorities in accordance with the schemes sanctioned by the legislature. The conventional budgets are framed by the various Ministries/Departments with expenditures broken down into the broad objects constituting the primary units of appropriation. These budgets are conceived largely in financial terms emphasising thereby the financial aspects and not so much the physical accomplishments out of the proposed outlays. Precisely, the conventional budget is accountability-oriented and is intended, primarily, to facilitate itemised financial control.

Besides being the principal instrument of providing accountability to the legislature and the means for ensuring financial control, the budget is, in the context of State-oriented planned economic development, the chief instrument of fiscal policy, a principle device for the implementation of the projects set-out in the development Plans, a vehicle for carrying out the government's policies ond decisions, a tool for better management of the government's operations, and chief source of data in order to facilitate the decisions of the government on fiscal and economic issues.

With the recognition that the primary object of a sound budgetary system in a planned economy must be to ensure the achievements of Plan objectives, the concept of accountability has acquired a broader connotation than is understood from its conventional usage. In the context of planned economic development in which the public outlays are to play a dominant role, specific socio-economic goals are defined, availability of resources is assessed, and alternative programmes are selected to attain these goals. As such, the accountability, instead of being confined to ensure that the moneys are spent as sanctioned and are kept within the limits laid down in the appropriations, must extend to ensure that the targetted phyical results are achieved. It becomes essential, therefore, that the budget should reflect the pattern of development Plans in content and classification. The budget should reflect and reveal as to what was planned to be done in terms of physical targets, the output to be aimed at or services to be provided as envisaged in the development Plan and what has actually been achieved both in financial and physical terms. More specifically, by having a common classification for both the Plan as well as the budget, the instrument of budget could be made an operational document for carrying out the Plan objectives.

It is in this context that an assessment has to be made about the usefulness of the present budgetary system and identify its shortcomings. As it exists presently, it provides for financial and legal accountability,

[12]Adapted from, Administrative Reforms Commission, "Report of the Working Group on Performance Budgeting" in the *Report of the Study Team on Financial Administration*. New Delhi, May 1967, pp. 149-201.

but the usefulness of the system can be enhanced considerably if it could be devised to give a comprehensive account of the total efforts of the government in its financial aspects, the economics of its activities, the physical results that flow from them, and the exact relationship between inputs and outputs. The conventional budgetary system does not link the financial and physical aspects of programmes and activities nor does it provide an adequate amount of information on the effectiveness of money spent on such programmes and activities. It does not throw sufficient light for an overall view of the financial and physical aspects of such programmes and activities, and the accomplishments.

The question of introducing performance budgeting in the Indian context could, therefore, be viewed from two angles : (a) by pointing out the deficiencies in the conventional budgeting and considering the merits of the performance budgeting; and (b) by a consideration of the various arguments against the introduction of the technique of performance budgeting. Approach (a) has briefly been covered in the preceding paragraphs. As regards (b), various doubts and misgivings about the introduction of performance budgeting are detailed below :

(1) Quite a number of the purposes designed to be served by the technique of performance budgeting are presently being already served by the techniques and processes of economic planning in certain ways and consequently, introduction of the technique of performance budgeting would amount to duplication of effort.

(2) Sufficiently comprehensive data and information is now given in the budgetary documents on both the financial and physical aspects of governmental programmes and activities, supplemented by the annual reports of the Ministries/Departments, annual report on the working of commercial and industrial undertakings of the government, etc.

(3) The financial and legal accountability of the executive government to the legislature will be impaired by the introduction of performance budgeting.

(4) A bulk of the disbursements undertaken by certain Union Ministries/Departments, e.g., agriculture, education, etc., consist of grants to the States and other organizations. As such, their performance may not be capable of measurement at Union level.

(5) In the present institutional structure, a performance budget can, at best, be only supplementary to the existing conventional budget, and cannot in anyway supplant it.

(6) The utility of performance budget may be greater in the context of the relationships between the executive and the legislature as they exist in the U.S.A. In the Indian context, where the initiative in budgetary decision-making vests in the executive, the legislature being mainly concerned with sanctioning the policies formulated by the executive, the system may not be capable of achieving that degree of success as may be anticipated.

The Working Group examined these points and have come to the following conclusions.

(1) Commenting on the point that performance budgeting is largely a technique for planning, implementation and reporting, both in financial and physical terms, and that this is obtaining, in some measure, in our planning process, the Working Group remarked that "*prima facie*, the contention seems to be an oversimplification both of the concept of performance budgeting as also of the virtues of the planning process......The technique of performance budgeting is something more than a mere bridge between the financial and physical aspects of a programme. In so far as the planning process is concerned, the experience during the last decade or so has indicated the inadequacy of the link between the two. It is also observed that because of the absence of a rapport between the financial and physical aspects of a programme, budgetary estimates were often either underpitched or overpitched with consequential impact on the allocation of resources. It has also, in turn contributed in some measure to the gap between the physical targets and financial outlays. Thus, while programmes, targets, outlays, etc., exist in the planning process, there is a lacuna in the existing system in that there is no well-organized operational framework. To the extent that such a framework would be supplied by performance budgeting, it would be greatly strengthening the existing planning process."[13]

(2) The argument is advanced that progressively increasing data and information about the various programmes and activities of the government, financial as well as physical, is now given in the budget and the various documents attached to it. It is correct that the Explanatory Memorandum, Notes on Important Schemes furnished in the Demands for Grants, the Economic Survey, the Economic Classification of the Budget, the Annual Reports of the Ministries/Departments, and other documents do provide the legislature and the public at large a substantial amount of information. "While these developments have been in the right direction, it is to be recognised that unless these somewhat disjointed efforts are coordinated and brought into a well-knit, purposeful and cohesive whole at one place, they are not likely to be of much help either in the formulation of programmes or in the evaluation of performance. It has thus to be seen that though there were various developments, welcome in themselves, yet, in the absence of a comprehensive scheme for budget-reform and also because they were often the result of attempts at meeting the requirements from different quarters, they tended to be diffused and were thus inadequate."[14]

(3) The contention that under performance budgeting, as emphasis is shifted to programmes and activities and their cost-benefit analysis, the legal and financial accountability of the executive government will be affected, appears to be based on erroneous impression. This contention may not be well-founded because the form and technique of performance budgeting could be formulated in such a way that the Ministries/Departments/Organisations may retain their identity and the Demands for Grants can continue to be in terms of objects of expenditure (i.e.,

[13]*Ibid.* pp. 168-169.
[14]*Ibid.*, p. 168.

units of appropriation) under the several programmes and activities of the Ministries/Departments/Organisations. The legal and financial accountability of the executive government would not, therefore, be compromised, rather more important aspects of accountability will result and be secured.

(4) As regards the difficulties contemplated for the evaluation of the results out of loans and grants given by the Union Ministries/Departments, it is a matter of detail regarding the form and content of performance budgeting rather than the principles underlying it.

(5) The fifth argument relates to the form in which the performance budget is to be prepared and presented. The issue involved is whether it should be a supplementary document to the conventional budget or should replace the latter. That the performance budget should be a supplementary document to the conventional budget is supported on two points : (a) it may not be desirable to change an established practice; and (b) it would not be possible to prepare a performance budget within a period of three months that now forms the crucial period during which the budget is finalized and presented. It is contended, however, that "it would not be sufficient to have the performance budget document as a supplementary one to the existing set of documents, as in that case it will not have any impact whatsoever on the existing system. For one thing, the performance budget is being evolved to overcome the deficiencies in the existing budgetary process and framework and not to supplement it. The idea of a supplementary document in such a context would inevitably mean the continuation of the existing procedures, financial practices, accounting classification, etc., with their inadequacies. Indeed, if performance budgeting is not made an integral part of the budgetary process, but only an additional exercise, unconnected with the main process, the advantages that are expected of it would not materialize. Secondly, performance budget is not merely a matter of form; it represents a change in concepts that has significant effects on the approach to the budget and the decision-making practices. The form is only the culminating point of the various processes towards better management and control. The form of the document has no special significance apart from the presentation effect. The performance budget as a supplementary document would be somewhat of a fifth wheel to the coach. The appropriate method in the circumstances would be to adopt, evolve and introduce performance budgeting in such a way that it would fit in without conditions and mitigate the transitional difficulties involved in the switchover, while continuing, at the same time, to serve the purposes expected of it."[15]

As regards the practicability of preparing a performance budget within a period of three months referred to above, it is contended that "in our planning process, both the implementation of programmes and the evolving of new ones are a continuous process throughout the year. Thus, in a way, budgeting would also be an all-the-year round process with the final stage of consolidation being reached in the period referred to above. Moreover, even under the present system, the administrative departments and organizations are enjoined upon to forward their budget

[15] *Ibid.*, pp. 169-170.

proposals quite early in the financial year, say beginning with July. Information on programmes, activities, targets, achievements and other work-load data will be available continuously all through the year through a performance reporting system."[16]

(6) Coming to the executive-legislature relationship, it may be pointed out that the need for the performance budgeting does not hinge on the character of such relationship.

It may be concluded that the introduction of the technique of "performance budgeting is needed more than ever, for integrating the Plan and budgetary process, for building up an internal edifice of the financial outlays and accomplishment for each administrative agency, for quantification of the results from government outlays, for enabling a more purposive audit and preliminary review and control, and thus serving as a window, so to say, to every citizen of the country on the governmental activities."[17]

4

Pre-requisites for the Introduction of Performance Budgeting in India

The more important pre-requisites necessary for the introduction of performance budgeting in India may now be examined :

(a) Performance budgeting involves the measurement and evaluation of end-products of a programme or activity. Since in a sizeable part of government operations there are no end-products, the utility of the concept may not be realized in practice. Even in cases where the end-products can be identified and quantified, there appears to have been no systematic effort at evolving work or performance units with a view to measuring the physical progress or accomplishments with few exceptions like Public Works Department. "It may, however, be mentioned here that the idea of measuring workload is not altogether unknown in India. Apart from the P.W.D., the O&M Units of the Ministries and the Staff Inspection Unit (previously Special Reorganization Unit) of the Ministry of Finance, etc., have been engaged for quite some time in evolving work-load factors, indices and ratios in respect of manpower utilization and related aspects and have been adopting the technique of work study, work measurement etc......These studies can be carried further and suitable yardsticks/norms evolved in due course, for measuring the output and accomplishments."[18]

Moreover, physical measurement may be of three types : (i) measures of accomplishment showing the effect of the work and the achievement of objective or programmes; (ii) measures of end-products reflecting the results of the work or output; and (iii) measures of workload bringing out the volume of work, or the volume of work and time, or the volume, time and costs. In combination with data on the employment of labour, the time spent and the resources expended, performance or work

[16] *Ibid.*, p. 170.
[17] *Ibid.*, p. 171.
[18] *Ibid.*, p. 175.

measurement or productivity ratios can be developed to show results in terms of units.

(b) The success of preformance budgeting presupposes a system of advance programming of the government operations on a long-term basis. In the context of planned economic development, a long-term planning with annual break-down is already in vogue, indications already exist about operational tasks, time schedules, targets and other aspects. With greater emphasis now being placed on the process of annual Plans, it should be possible to frame budgetary requests adequately supported by necessary administrative planning and projection into the future.

(c) It is contended that under a system of performance budgeting, the outlay shown in the budget documents for any programme or activity should represent the total cost of such a programme of activity and should be available at one place. This could be possible only if all outlays are classified on a functional basis irrespective of the Departments/Organisations incurring them, a proposition which does not seem to be feasible under the existing circumstances.

(d) Under the existing cash accounting basis, the cost of a programme or activity as shown in the budget may not represent the total cost of the programme or activity. "It has been recognised that, in the initial stages, accounts should not be unduly disturbed. Refinements such as accrual accounting, allocation of overheads like general administration and common services, etc , may also be deferred to a latter stage. The introduction of preformance budgeting elsewhere has not been made contingent on shift from cash to accrual basis. Moreover, the advantage to be gained by having total or full or accrued cost may not be commensurate with the cost and labour involved in a radical departure immediately from the long established accounting systems and practices."[19]

(e) Another pre-requisite for preformance budgeting is that the execution of the budget and the authority administering the programmes must be concentrated in one agency. Such an identification has been rendered possible, to a considerable extent by the enhanced delegation of powers to the administrative Ministries/Departments and the recent changes affected in the budgetary procedures. "With the greater delegation of financial powers and the increasing association of the representatives of the administrative Ministry with the budgetary process, the state of affairs will increasingly approximate to the ideal situation where the budgeting and administering agencies will be the one and the same. Also, if suitable norms and standards could be laid down in respect of a wider field of governmental activities as is inherent in performance budgeting and if the financial management skills could be developed in the administrative Ministries, they, with the aid of their financial advisers, will be able to formulate budgets in such a manner as to obviate the necessity of modification in a large measure by an outside agency, i.e., Finance Ministry."[20]

(f) Another important step towards the introduction of performance budgeting is to evolve the necessary financial data through the accounting

[19] *Ibid.*, p. 177.
[20] *Ibid.*

system in terms of programmes and activities. The existing accounting system would require, therefore, to be modernized so as to meet the requirements of performance budgeting.

(g) In the context of performance budgeting. another point which is commonly stressed is the need to strengthen the reporting system. An adequate system of performance reporting is, without doubt, an indispensable adjunct to performance budgeting. "At present, reporting is mainly in financial terms in the context of and on the lines of budgetary appropriations......With a view to relating financial progress with actual achievements, it is necessary that both the physical and financial aspects are interwoven into a single report against a background of time and cost and a projection into future commitments. Such a performance reporting at regular intervals is an indispensable aid to performance budgeting and expenditure control."[21]

"The introduction of performance budgeting in the existing circumstances and at this stage of the development of our institutions and procedures may be attended with some initial difficulties. But these difficulties should be capable of being resolved in a satisfactory manner, given the necessary motivation, resources and a spirit of cooperation. The benefits to be derived from the new technique should not be viewed in terms of costs involved, but have to be viewed in the larger context of securing benefits resulting from more effective control, greater efficiency and all-round improvement in governmental operations. The conversion to performance budgeting has to be viewed as a major step towards the improvement of the budgeting structure with a view to better comprehensibility and towards making budget a programme-oriented document. Having regard to the significant changes involved, the installation process should, of necessity, be carried out in a phased manner. In the nature of things, the introduction of this technique has to be an evolutionary process to be developed and extended gradually over a number of years."[22] In such a process of phased application, priority shall have to be accorded to Departments/Organisations directly involved in development programmes and activities, and which account for a sizeable part of development expenditure in the Plan and the budget.

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[21] *Ibid.*, p. 178.
[22] *Ibid.*, p. 182.

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