"Management of Government Finances in India –Emerging Challenges and Prospects"

A K Sharan[1]

Abstract

In modern times the economies emerge in different manner(s) with specific facets and shades, quite often unforeseen. Such emergence of facets and shades of development and growth, or otherwise, characterising *Prof. Raj Krishna's thesis*, baffle the economic managers. It can happen in the most economies such as US and European economies, and / or in transition economies such as African, South Asian economies, to just mention some. The present century economies have duality of prosperity goals – socio-economic (including infrastructure) and fiscal-financial. Whereas the former goal has several constraints for its optimized accomplishment by the economic manager, the lattercan be otherwise accomplished with rules and regulations backed by sound principles of 'New Public Management' and fiscal financial prudence, besides incorporation of (*select and adaptable*) best international practices.Indian economy is quite an emerging one, not in the typical sense of format of economic development and growth but in the very arena of sustained fiscal-financial health on an aggregate level i.e. *fiscal-financial health of union and provincial governments*. The experimentation effected by the Government of India (GoI) and the Sub-national (provincial) governments in the past decade has been seen as worth commendation, both inside India as also regionally and internationally.The legislation of fiscal-financial charters has immensely benefitted the cash, financial and fiscal management of the GoI and the Sub-national governments in terms of their capacity building (*in relative terms for major state economies*). According to the authors of the India's Real Fiscal Policy for the FY 2016 "*Thefear about furthering fiscal federalism (by adopting the recommendations of the FFC) was that it would undermine, or not be completely consistent with the direction of, the Centre's fiscal policy. If the Budgets recently presented by the states are any indication that fear has been allayed because on all three counts – consolidation, quality, and growth-enhancing potential … … …On public finances, the states and the Centre appear to be partners in sync*".Indian economy today aims at strengthening its

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fundamentals for which the proxies are consumption, savings, investment, production, inflation rate, foreign exchange rate, to mention some. Stability on these counts would, to a larger extent depends upon sound fiscal-financial health. Besides, legislation for fiscal management, a lot many reforms and interventions by the government are on the wait in the banking sector, which is a substantively larger chunk of the Indian financial system.

Key Words **:** Economic Managers, Krishna Raj's Thesis, Bank Reforms, Fiscal Management, Indian Financial System.

JEL Classification : A-10, B0, D03, H30, E02.

> *The International Monetary Fund has hailed India as a 'bright spot' amidst a slowing global economy. The World Economic Forum has said that India's growth is 'extraordinarily high'. We accomplished this despite very unfavourable conditions and despite the fact that we inherited an economy of low growth, high inflation and zero investor confidence in Government's capability to govern. We converted these difficulties and challenges into opportunities.*
>
> *कश्तीचलानेवालोंकीकभीहारनहींहोती*
> *लहर-लहरतूफ़ानमिलेऔरमौजमँझदारहमें*
> *फिरभीदिखायाहैहमनेऔरफिरयेदिखादेंगेसबको*
> *इनहालतमेंआताहैकरनादरियापरहमें*
>
> - Arun Jaitley

Government finances essentially deal with the receipts of public money and expenditure thereof. However, the whole gamut of process involved in the entire management of public money is not as simple as it could be in the management of private finances.

The making of Annual Financial Statement, the *Budget* in the national and the sub-national governments involves a great deal of finesse, besides massive deliberations. The entire government machinery involving whole range of Financial Advisors in all ministries, besides higher levels of economic advisors are involved almost throughout the year in preparing the leads for the coming budget. The Budget division of the Department of Economic Affairs is chiefly responsible for the final preparation of the Union Government Budget, to be place on the table of the Indian Parliament.*Article 112 of the Constitution of India* backs presentation of the budget in the Parliament by the Union Finance Minister on the last working day of February.

The Union Budget has two facets, the Receipts Budget and the Expenditure Budget. The receipts budget is broken down into revenue (*bothtax and non-tax receipts*) and the expenditure budget has plan and non-plan expenses (*both revenue and capital expenses*).

While revenues' (part of the receipts) side of the budget poses challenges pertaining to raising more and more of resources for meeting the ever escalating expenses of the government, the expenditure side has the challenge of prudence in the given context of fiscal and financial prudence, the social equity vis-à-vis globally matching developmental and growth requirements of the Indian economy.

The revenues to the government, coming from taxation and non-tax sources never equate with the expenditure requirements, hence borrowing. Draw down on reserves and / or printing of currency notes have never been any sustainable solutions, therefore, there has always been a mounting pressure on public and or other sources of borrowing.

The budget speech statement of Arun Jaitley is crisp and loaded, and therefore, has clear indications that it is high time that we attend to, on priority, those areas of concerns which have not only been the needed areas of economic development and growth but have also reflected the concerns/aspirations of the common man in micro interiors of India.

The rural population[2] in India, per World Bank date, has de-escalated from approximately 82 per cent in 1960 to about 67 per cent in 2015. The global de-escalation averages have been from 66 per cent to about 46 per cent during the same period. However, the Registrar General of India and Census Commissioner mentioned "for the first time since independence, the absolute increase in population is more in urban areas than in rural areas. The rural-urban distribution is 68.84 per cent and 31.16 per cent respectively,"

The earlier plan (Eleventh National Development Plan) ascertained the no. of poor people in India more than 300 million. However, it is encouraging and heartening too that as

[2] Rural population refers to people living in rural areas as defined by national statistical offices. It is calculated as the difference between total population and urban population. World Bank Staff estimates based on United Nations, World Urbanization Prospects.

country we have been bring down the poverty approximately from 55 per cent (1973) to approximately 27 per cent (2004). Among the factors that have rendered and / or sustained poverty among people of India (elsewhere as well) have included diverse range of causes such as failure to acquire productive assets. Miserable/absent financial resources coupled with illiteracy, ill-health, failure to access social services and many more. In terms of Tendulkar[3] methodology, ‘*below poverty line*’ (BPL) population has remained approximately around 29.8 per cent (2009-10), which also included 33.8 per cent rural and 20.9 per cent urban segments. According to Dr. M S Ahluwalia[4] "*... ... ... We aim to reduce poverty estimates by 2 per cent annually on a sustainable basis during the Plan period*".

In the recent years the union government has shifted its focus on to utilising the earlier outcome of previous economic reforms as sustained building blocks, and this is seen as a paradigm shift from earlier endeavours, in so far as macroeconomic perspective of the economy is concerned.

Notwithstanding the earlier philosophy of ‘*hindu growth rate*’ (old/new) the thrust is now observed as reviving the growth by eliminating the policy paralysis.

The host of attendant measures have been perceived as removing the infrastructural bottleneck constraints of the economy together with other structural constraints – moving from structural rigidity to structural resilience. Such a move would be ill-conceived in the absence of enhanced inflows of foreign investment – drawing fine balance between ‘*crowing-in*’ and ‘*crowing-out*’ of investments in view of growing importance of social sector in the economy.

The above all calls for a collective, cohesive, well-coordinated, well committed and well planned and conceived attention on, besides many more, each of the following :

- Perspective developed/build-up by the planners ahead of five years vis-à-vis the role of economic managers;
- Social and gender empowerment
- Reforming the financial system – calling for massive bank / market reforms; and
- Enhanced fiscal management.

[3] Late Dr. S Tendualkar, formerly member PMEC 2008-09

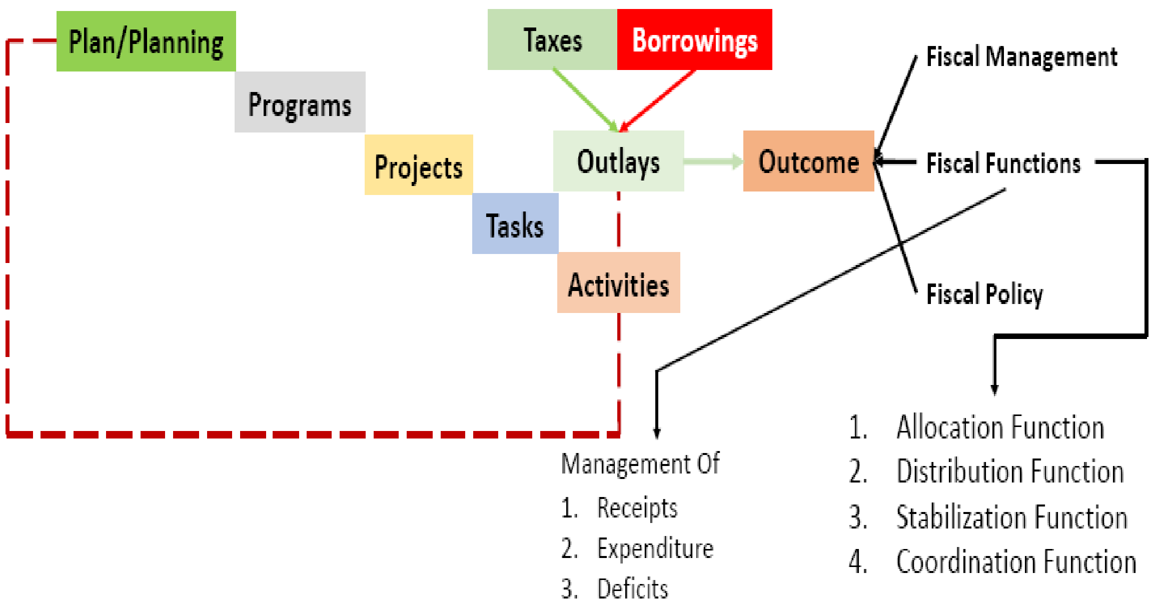
[4] Ex-Deputy Chairman, Planning Commission of India (12th Plan)

As a matter of fact budgeting, accounting, and costing (the larger face of financial management) in the government cannot be seen as watertight compartments. This when juxtaposed to the social responsibilities of the government in terms of the planning, makes it amply clear that the entire exercise of management of economy (*in all sectors, including external sector*) is nothing but policy-led financial management in the government, intended at generating value for money. Most possibly, this is also the basic tenet of ‘New Public Management’ / ‘Good Governance and Responsive and Value Based Administration in India’ (*and the rest of the world as well*).

In several areas, concerning social and economic governance, we have seen, experienced and are convinced that the two sectors of the economy, viz. economic sector and social sector, are so tightly interwoven that one simply would not survive without the other, hence accounting, budgeting and costing (*of sectors and activities*) require a cohesive strategy in the packaging of ‘*New Public Management*’.

According to Osborne and Gaebler (1992); Borins (1994);and Hughes (1998) “... ... ... *New public management reforms, it is said, are a common response to common pressures - public hostility to government, shrinking budgets, and the imperatives of globalisation. There are differing interpretations of what that common response consists of. But there is general agreement that key components include deregulation of line management; conversion of civil service departments into free-standing agencies or enterprises; performance-based accountability, particularly through contracts ... ...*” Aucoin (1990) and Hood (1991) have opined in favour of “... ... ... *competitive mechanisms such as contracting-out and internal markets*”. Authors like Ingraham (1996) and Minogue (1998) have advocated “... ... ... *privatisation and downsizing as part of the package*”.

In short, the overhauling of long surviving systems of management in the government, call it by whatever name, requires to be revisited in order to meet aspiration of the people and also meet the global challenges. The following flow chart reveals a notional/indicative but most accurate trajectory of the linkage between planning and budgeting (*in India*).



From the above chart we can easily see that the connectivity of output and outcome gets candidly established via fiscal management. Accordingly emphasis on financial/fiscal management of the government doesn't overshadow the policy perspective of the government disproportionately.

The components of budget as given in the flow chart can be expressed in terms of the official format of the Government of India as under:

1	**Revenue Receipts**	
	2	Tax Revenue (net to centre)
	3	Non-Tax Revenue
4	**Capital Receipts (5+6+7)**	
	5	Recoveries of Loans
	6	Other Receipts
	7	Borrowings and other liabilities
8	Total Receipts (1+4)	
9	**Non-Plan Expenditure**	
	10	On Revenue Account of which,
	11	Interest Payments
	12	On Capital Account
13	**Plan Expenditure**	
	14	On Revenue Account

	15	On Capital Account
16	**Total Expenditure (9+13)**	
	17	Revenue Expenditure (10+14)
	18	Of Which, Grants for creation of Capital Assets
	19	Capital Expenditure (12+15)
20	**Revenue Deficit (17-1)**	
21	**Effective Revenue Deficit (20-18)#**	
22	**Fiscal Deficit {16-(1+5+6)}**	
23	**Primary Deficit (22-11)**	

Source : Budget at a Glance 2016-17.
Note : The budget format given above doesn't reflect "*Current Account Deficit*" (CAD) in the external sector.

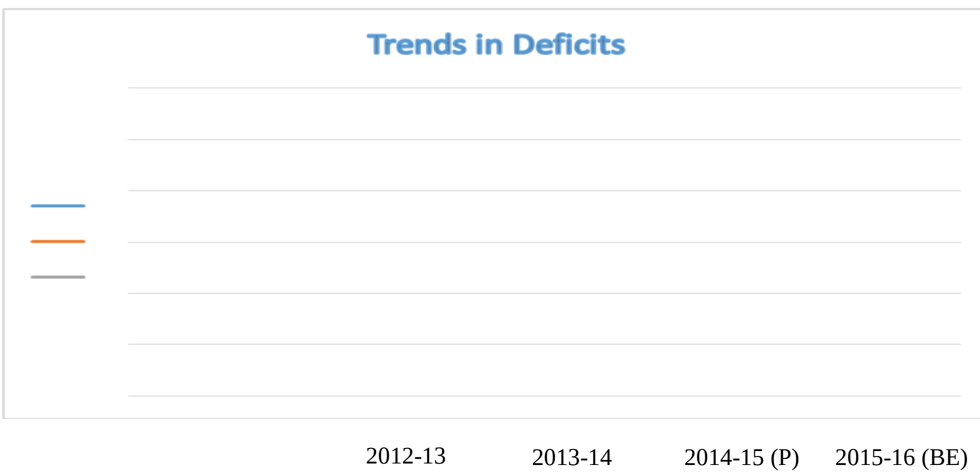
In no uncertain terms, then, the perspective of the financial management of the government is all about "*Budget Management*". And, this is further substantiated from the fact that when India wanted a legislation in this regard it came out with "***Fiscal Responsibility and Budget Management Act*** **(2003)**", which has since been amended. The spirit of the FRBMA, later promulgated by respective member States of the "*Indian Federation*". The FRBMA 2003 (read with amendments) believes in the enforcement of a sound, sustainable fiscal discipline that would permit public authorities expend the public money with full prudence and the money thus spent has a corresponding outcome.

Over the years the position of various deficits has not been very encouraging at an aggregate level, for the economy as a whole. In addition, the other fiscal indicator have also necessitated policy attention. If we glance through various indicators such as receipts and expenditure, both revenue and capital, we find menacing gaps between the resources available and the resources committed for expenditure. The following two tables give us fair idea of deficits, receipts and expenditure:

Table showing Fiscal Indicators of the Centre

Fiscal Indicator	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
			P	**BE**				**BE**
	` *Lac Cr.*				Per Cent of GDP			
Revenue deficit	3.6	3.6	3.6	3.9	3.7	3.2	2.9	2.8
Fiscal deficit	4.9	5.0	5.0	5.6	4.9	4.5	4.0	3.9
Primary deficit	1.8	1.3	1.0	1.0	1.8	1.1	0.8	0.7

Source : Economic Survey 2016, Chapter 2, page 31.
Note : Extracted and reproduced



Fiscal Indicator	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
			P	**BE**				**BE**
	` *Lac Cr.*				Per Cent of GDP			
Revenue receipts	8.8	10.1	11.0	11.4	8.8	9.0	8.8	8.1
Net tax to centre	7.4	8.2	9.0	9.2	7.5	7.2	7.2	6.5
Gross tax revenue	10.4	11.4	12.5	14.5	10.4	10.1	10.0	10.3
Total expenditure	14.1	15.6	16.4	17.8	14.2	13.8	13.2	12.6
Revenue expenditure	12.4	13.7	14.6	15.4	12.5	12.2	11.7	10.9
Capital expenditure	1.7	1.9	1.9	2.4	1.7	1.7	1.5	1.7

Source : Economic Survey 2016, Chapter 2, page 31.
Note : Extracted and reproduced

The above two tables give us a macro scenario in which we find that capital expenditure has been increasing, both in terms of absolute value and as per cent to GDP terms. The revenue deficit has still been sumptuous and fiscal deficit has exceed the prescribed limits.

As per Economic Survey 2015-16) “*The agreement on monetary policy framework signed between the Government and Reserve Bank of India (RBI) in February 2015 has shaped the monetary policy stance in 2015-16. The RBI further eased its monetary policy stance during the year 2015. Headline inflation based on the consumer price index (CPI) fell to below 6 per cent much ahead of the January 2016 target. The RBI reduced the statutory liquidity ratio by 0.50 per cent to 21.50 per cent in February 2015 and further eased the policy repo rate during the year to 6.75 per cent, in all making a substantial cut of 125 basis points (bps) between January 2015 and September 2015 (Table 3.1). In the bank’s latest monetary policy review held on 2 February 2016, the policy repo rate remains unchanged*”. This beginning statement of Chapter 3 of Economic Survey (2015-16) clearly states that targeting of inflation has been not out of focus of the central banker, viz. the Reserve Bank of India (RBI). Besides the base rates have also shown encouraging trends in supporting lendable resources with the system. The following tables reveals the scenario between 204-15:

Table showing variations in specific RBI rates.

Effective Date (s)	Bank Rate/ MSF Rate* (Per Cent)	Repo Rate (Per Cent)	Reverse Repo Rate (Per Cent)	Cash Reserve Ratio (Per Cent Of NDTL)	Statutory Liquidity Ratio (Per Cent Of NDTL)
09-08-2014	9.00	8.00	7.00	4.00	22.00
15-01-2015	8.75	7.75	6.75	4.00	22.00
07-02-2015	8.75	7.75	6.75	4.00	21.50
04-03-2015	8.50	7.50	6.50	4.00	21.50
02-06-2015	8.25	7.25	6.25	4.00	21.50
29-09-2015	7.75	6.75	5.75	4.00	21.50

Source : Economic Survey 2016, Chapter 2, page 31.
Note : Extracted and reproduced

From the above table we ascertain that between the period under reference financial stability has been there in money market, which is the primary focus in financial sector management, in so far as rates in the money market affect the rates in the capital markets, besides heavy dependence on the government on the money market. Money market reforms of 1980s have paid suitable dividends in fiscal consolidation in India. It was the strength that we derived from the money market that led the FRBMA of 2003 to facilitate '*debt-swap*' scheme of the Government of India.

"*The economic performance of a country goes beyond increases in Gross Domestic Product and Per Capita Incomes and encompasses enhancement of opportunities and improvement in social infrastructure such as education, health, housing and housing amenities; levels of employment and employability of the nationals, proportion and number of poor; is reflected by individual indices such as enrolment and literacy ratios, mortality rates, spread of immunisation, control of major diseases; access to safe drinking water and toilets and captured by an aggregate human development index, which needs to be calculated annually state-wise. All this economic development has to be in an inclusive manner covering the deprived/marginal sections including women and all states*" are the opening remarks in Chapter 09 of the Economic Survey (2015-16). Over a period the important milestones have started being governed by the tenets of *Human Development*, rather merely by *Economic Development*, however, though the two are not mutually exclusive. As such education, health and micro enterprises have been the prime focus, besides, micro finance and generation and nurturing of *Self-Help Groups*. The approach to '*gender budgeting'* has proven that in India there is a persevered move towards gender empowerment. The following table depicts shifting priority focus on the social sector:

Trends in Social Services Expenditure by Government (Centre and States)

Item/ Year	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
	As percentage to GDP							
Total Expenditure	28.4	28.6	27.6	27.4	27.0	26.2	28.1	27.0
Expenditure on social services	6.8	6.9	6.8	6.6	6.6	6.5	7.0	6.7
of which:								
i) Education	2.9	3.0	3.1	3.1	3.1	3.0	3.1	3.0
ii) Health	1.3	1.4	1.3	1.2	1.3	1.2	1.3	1.3

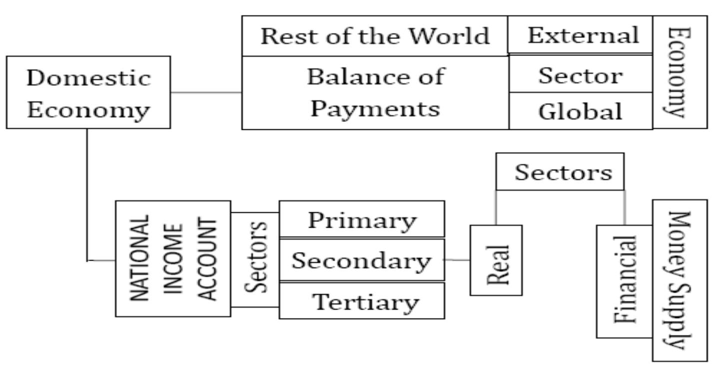
iii) Others	2.6	2.5	2.4	2.2	2.2	2.3	2.6	2.4
As percentage to total expenditure								
Expenditure on social services	23.8	24.1	24.7	24.0	24.4	24.8	24.9	24.9
of which:								
i) Education	10.1	10.6	11.4	11.4	11.6	11.6	10.9	11.2
ii) Health	4.6	4.8	4.7	4.6	4.7	4.6	4.8	4.9
iii) Others	9.0	8.7	8.6	8.0	8.2	8.6	9.1	8.9
As percentage to social services								
i) Education	42.6	44.1	46.1	47.7	47.5	46.7	44.0	44.9
ii) Health	19.5	19.7	19.0	19.0	19.1	18.6	19.3	19.5
iii) Others	37.9	36.1	34.9	33.3	33.4	34.7	36.7	35.6

Source : Economic Survey 2016, Chapter 2, page 31.
Note : Extracted and reproduced

The trend that manifests from the above table is indicative of the trend that social sector has been given due importance especially in terms of education and health, besides other social services. Education has been on the top in terms of getting priority attention among social services followed by health. Both of these have been key components of the human development. This genuinely drawn focus of the government to the social sector has also help country improve its rank on the *Human Development Index* (*HDI*)[5].

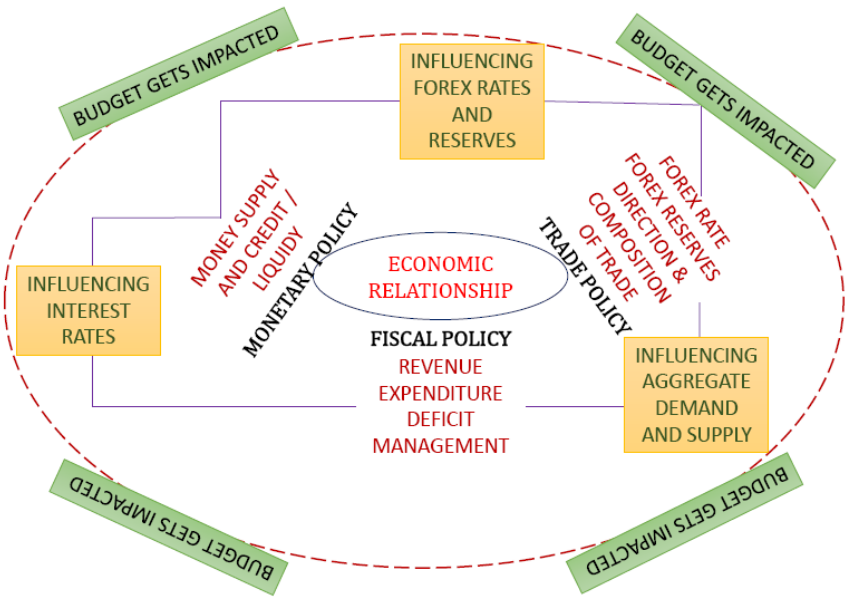
In essence, therefore, the financial management in the government is a creative coordination between and among several economic policies, which harmonise domestic prosperity with the prospects of external sector. The following two charts fully depict this coordination and harmonization :

Chart 1 Depicting the Inter-dependence of Domestic and External Sectors



[5]2015 HDI

Chart 2 Depicting the Independence of the Macroeconomic Policies vis-à-vis Three Sectors



The above charts give clear impression that there needs to be a well-coordinated approach towards economic and especially financial management in government. The importance of financial management in government is of paramount significance, particularly in view of the fact that nature and size of government expenditure, both plan and specially non-plan, the care and prudence towards accomplishment of value for money/outcome of expenses from the government coffers. In other words the expenditure and borrowing programs of the government ought to be finely costed before their occurrence. Thus we need in place sector costing strategies, dovetail our accrual accounting system with outcome orientation of the budget.

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