BUDGET : CONCEPTS AND FORMS

Financial administration is an important facet of public administration. It operates through the instrument of 'Budget' and encompasses the entire 'budgetary cycle', that is, formulation of the budget, enactment of the budget, execution of the budget, accounting and auditing.

According to C.P. Bhambhri, "the term 'budget' was used in its present sense for the first time in 1773, in a satire entitled 'Opening the Budget' directed against Walpole's financial plan for that year".

Significance

The popular statements made on the importance of financial administration to the government administration are mentioned below.

Aaron Wildavsky: "Budget is the life blood of the government."

Kautilya: "All undertakings depend upon finance. Hence, foremost attention shall be paid to the treasury."

Hoover Commission: Financial administration is "at the core of modern government."

Lloyd George: "Government is Finance."

Morstein Marx: "Finance is as universally involved in administration as oxygen is in the atmosphere."

Meaning

The term 'Budget' is derived from an old English word 'Bougett' which means a sack or pouch. It was a leather bag from which the British Chancellor of Exchequer extracted his papers to present to the Parliament the government's financial programme for the ensuing fiscal year. From that association, it came to mean the papers themselves, especially those containing financial proposals.

The budget is a statement of the estimated receipts (revenue or income) and expenditure of the government in respect to a financial year. In other words, it is a financial document of the government as presented to the legislature and as sanctioned by the legislature.

Functions

The following points highlight the functions or purposes of budget.

1. It ensures the financial and legal accountability of the executive to the legislature.
2. It ensures the accountability of subordinates to superiors in the administrative hierarchy.
3. It is an instrument of social and economic policy to serve the functions of allocation, distribution and stabilisation.
4. It facilitates the efficient execution of the functions and services of government.
5. It facilitates administrative management and coordination as it unifies the various activities of the government departments into a single plan.

Principles

The principles of sound budgeting are:

Budget should be on Annual Basis This means that the legislature should grant money to the executive for one year only. This principle of annuality of budget is considered ideal because: (a) a year is the optimum period for which the legislature can afford to give financial authority to the executive; (b) a year is the minimum period needed by the executive to implement the budget effectively; and (c) a year corresponds with the customary measure of human estimates. Presently, the financial year in India is from 1st April to 31st March. However, the Administrative Reforms Commission of India (ARC) recommended that the financial year should be from 1st November to 31st October.

Estimates should be on Departmental Basis This means that the expenditure and revenue estimates of budget should be prepared by the department directly dealing with them, irrespective of the fact that such expenditure or revenue is on account of another department. The observance of this principle is suggested because: (a) it gives a clear picture of the programmes and activities of every department; and (b) it ensures the financial solvency of every department. However, to avoid any confusion in this regard, the department preparing the estimates should give footnotes indicating the expenditure or revenue of that department dealt by another department.

Budget should be a Balanced One This means that the estimated expenditure should not exceed the estimated revenue. In other words, a 'balanced budget' is one in which the estimated expenditure matches the estimated revenue. If the estimated revenue is more than the estimated expenditure, it is called a 'surplus budget', and if the estimated revenue is less than the estimated expenditure, it is called a 'deficit budget'.

Estimates should be on a Cash Basis This means that the expenditure and revenue estimates of budget should be prepared on the basis of what is expected to be actually spent or received during the financial year. The opposite of 'cash budgeting' is called 'revenue budgeting', under which the budgeting estimates are prepared on a demand and liability basis, that is, the revenue and expenditure accrued in a financial year are included in the budget of that financial year regardless of whether they are actually realised or incurred in that financial year. The USA, UK and India have cash budgeting, while France and some other continental countries have revenue budgeting. Cash budgeting facilitates an early closure of public accounts than revenue budgeting. The delayed accounts lose much of their value for purposes of financial control.

One Budget for all Financial Transactions This means that the government should incorporate all its revenues and expenditure (of all the departments) in a single budget. The opposite of 'single budget' is 'plural budget' under which separate department-wise budgets are prepared. The single budget system reveals the overall financial position of the government as a whole, that is, overall surplus or deficit. The UK and USA have single budget, while France, Switzerland and Germany have plural budgets. India has two budgets, *viz*. general budget and railway budget.

Budgeting should be Gross and not Net This means that all transactions of receipts and expenditure of the government should be fully and separately shown in the budget and not merely the resultant net position. The practice of deducting receipts from expenditure or *vice versa*, and preparing the budget for net receipts or expenditure is not a sound principle of budgeting. This is because, it reduces the legislative control over finances due to incomplete accounts.

Estimating should be Close This means that the budgetary estimates should be as exact as possible. This is because, overestimating leads to excessive taxation and underestimating leads to ineffective execution of the budget. 'Close budgeting' also means that particular items of expenditure should be specified and there should be no demand for lumpsum grant.

Rule of Lapse The budget should be on annual basis, that is, the legislature should grant money to the executive for one financial year. If the granted money is not spent by the end of the financial year, then the balance would expire and should be returned to the treasury. This practice is known as the 'rule of lapse'. The financial year in India and the UK is from 1st April to 31st March, in the USA it is from 1st July to 30th June, and in France it is from 1st January to 31st December.

The rule of lapse facilitates effective financial control by the legislature as no reserve funds can be built up without its authorisation. However, the observance of this rule leads to heavy rush of expenditure towards the close of the financial year. This is popularly called as 'March Rush' in India.

Revenue and Capital Portions should be Separated This means that the current financial transactions of the government should be distinguished from the transactions of a capital nature and the two must be shown in two separate parts of the budget called the 'revenue budget' and the 'capital budget'. This necessitates the separation of operational expenditure from that of investment expenditure. The revenue budget is financed out of the current revenue while the capital budget is financed out of the savings and borrowings.

Form of Estimates should Correspond to form of Accounts This means that the form of budgetary estimates should correspond to the form of accounts to facilitate effective financial control. For example, the budgetary heads and accounting heads are same in India, that is, major head, minor head, subhead and detailed head.

Forms or Systems

The forms (systems) of budgeting which have evolved over a period of time are explained below.

Line-item Budgeting This is also called as traditional budgeting or conventional budgeting. This system of budgeting developed in the 18th and 19th century. It emphasises on the items (objects) of expenditure without highlighting its purpose and conceives budget in financial terms. In other words, it presents budget in terms of objectwise (line-item) classification. Under this system, the amount granted by the legislature on a specific item should be spent on that item only. The objectives of this budgeting are to prevent wastage, over-spending and misuse of money granted by the legislature to the executive. This system of budgeting facilitates maximum control of public expenditure. In fact, the sole object of line-item budgeting has been the accountability of funds, that is, ensuring legality and regularity of expenditure. This system is also called as 'incremental budgeting' as the funds are allotted on an incremental basis after identifying the existing base.

Performance Budgeting The system of performance budgeting (earlier called as functional budgeting or activity budgeting) originated in the USA. The term 'performance budget' was coined by the First Hoover Commission (1949). This commission recommended the adoption of performance budgeting in the USA to make effective management approach to budgeting. Accordingly, it was introduced in 1950 by President Truman.

Unlike the line-item budgeting, the performance budgeting emphasises on the purpose of expenditure rather than the expenditure itself. It presents budget in terms of functions, programmes, activities and projects. It establishes a correlation between the physical (performance or output) and financial (input) aspects of each programme and activity. Hence, it necessitates a functional classification of the budget.

In India, the adoption of performance budget was recommended first by the Estimates Committee of Parliament in 1956. In 1964, the Government invited Frank W. Krause, an American expert, to study the suitability and feasibility of this system of budgeting in India. Finally the Central Government introduced performance budgeting in 1968 on the recommendation of the Administrative Reforms Commission. According to this commission, the advantages (benefits/objectives) of the performance budgeting are as follows:

(i) It presents more clearly, the purposes and objectives for which the funds are sought by the executive from the Parliament.
(ii) It brings out the programmes and accomplishments in financial and physical terms.
(iii) It facilitates a better understanding and better review of the budget by the Parliament.
(iv) It improves the formulation of the budget.
(v) It facilitates the process of decision-making at all levels of government.
(vi) It increases the accountability of the management.
(vii) It provides an extra tool of management control of financial operations.
(viii) It renders performance audit more purposeful and effective.

In 1968, the performance budgeting was introduced in four ministries of the Government of India. Later in 1977–78, it was extended to about 32 developmental departments.

Programme Budgeting Like performance budgeting, programme budgeting (also known as planning-programming-budgeting system—PPBS) also originated in the USA. It was introduced in 1965 by President Johnson. However, it was abandoned in 1971. This system of budgeting integrates the planning, programming and budgeting functions. It incorporates a scheme of planning in the budgeting process. In the words of K.L. Handa, "Programme budgeting or PPBS emphasises the planning aspect of budgeting for selecting the best out of a number of available programmes and for optimising the choice in economic terms while allocating funds in the budget.... It treats budgeting as an allocative process among competing claims to be conducted by using the relevant planning techniques."

Zero-based Budgeting (ZBB) The ZBB also originated and developed in the USA. It was created in 1969 by Peter A. Pyhrr, a manager of a private industry. It was introduced in the USA by President Jimmy Carter in 1978.

Like the performance budgeting or PPBS, the ZBB is also a rational system of budgeting. Under this system, every scheme should be reviewed critically and rejustified totally from zero (or scratch) before being included in the budget. Thus, the ZBB involves a total re-examination of all schemes afresh (from base zero) instead of following the incremental approach to budgeting which begins with the estimation of the current expenditure. In the words of K.L. Handa, "The basic feature of a zero-based budget is that the departments, while preparing their budgets, should not take anything for granted and, therefore, should start on a clean slate. The budget making for the ensuing year should be started from zero instead of treating the current budget as the base or the starting point."

The *advantages/benefits* of ZBB technique are:

(i) It eliminates or minimises the low priority programmes.
(ii) It improves the programme effectiveness dramatically.
(iii) It makes the high impact programmes to obtain more finances.
(iv) It reduces the tax increase.
(v) It facilitates critical review of schemes in terms of their cost-effectiveness and cost benefits.
(vi) It provides for quick budget adjustments during the year.
(vii) It allocates the scarce resources rationally.
(viii) It increases the participation of the line personnel in the preparation of budget.

In India, the ZBB was first introduced in the Department of Science and Technology in 1983 and in all the ministries during 1986–87 fiscal year.

Sunset Legislation It is a formal process of policy review for eliminating the undesired, outdated, redundant and irrelevant programmes. In the words of K.L. Handa, "It embodies the concept of self-retiring government programmes by providing for the termination of statutory authorisation of programmes. This is achieved by placing time limits on government programmes in the legislative enactments themselves and providing for their automatic termination on the prescribed dates unless, affirmatively recreated by legislature after conducting a detailed review."

The *advantages* or *benefits* of the sunset legislation are as follows:

(i) It ensures economy in government expenditure.
(ii) It avoids unnecessary expansion of government activities.
(iii) It makes the financial resources available for new programmes.
(iv) It ensures administrative rationality by facilitating the reallocation of limited funds on a continuous basis.
(v) It helps in overcoming the resistance met within the executive for eliminating an ongoing programme by shifting the major responsibility for its evaluation to the legislature.

Top-Down Budgeting The system of Top-Down Budgeting was introduced in the USA in 1981 during the Reagan era. It is also known as 'Target Base Budgeting'. It has the elements of earlier systems of budgeting, that is, performance budgeting, PPBS, Management by Objectives (MBO), ZBB and Sunset Legislation.

Nicholas Henry has defined Top-Down Budgeting as "a method of allocating public revenues to the agencies in which agency spending limits (and, often, agency goals, too) are set by the chief executive officer of the government, while agency heads are permitted to attain their goals in the manner that they deem to be most effective within these centrally set spending limits". He further observed, "Top-Down Budgeting clearly empowers the central administration to set expenditure and programmatic goals; therefore, it is a complete reversal of the traditional budgetary process in government, which is bottom-up. The real system of budgeting now is from the top downward."

Historical Perspective

The institutions of financial administration originated and developed in modern India during the period of British Rule. The following points can be noted in this regard:

(i) In 1753, the Indian Audit and Accounts Department was created.
(ii) In 1860, a system of budget was introduced.
(iii) In 1870, financial administration was decentralised by Lord Mayo. Consequently, provincial governments were made responsible for the management of local finances.
(iv) In 1921, the Railway Budget was separated from the General Budget on the recommendation of the Acworth Committee.
(v) In 1921, Public Accounts Committee was created at the Centre.
(vi) In 1935, the Reserve Bank of India was established by an Act of Central legislature.

FORMULATION OF BUDGET

'Formulation of the budget' means the preparation of the budget estimates, that is, preparing the statement of estimates of expenditure and receipt (income) of the Government of India in respect of each financial year. The financial year in India is from 1st April to 31st March.

The Constitution refers to the budget as the 'annual financial statement'. In other words, the term 'budget' has nowhere been used in the Constitution. It is the popular name for the 'annual financial statement' that has been dealt with in Article 112 of the Constitution.

In addition to the estimates of receipts and expenditure, the budget contains certain other elements. Overall, the budget contains the following:

1. estimates of revenue and capital receipts,
2. ways and means to raise the revenue,
3. estimates of expenditure,
4. details of the actual receipts and expenditure of the closing financial year and the reasons for any deficit or surplus in that year, and
5. economic and financial policy of the coming year, that is, taxation proposals, prospects of revenue, spending programme and introduction of new schemes/projects.

Agencies

The four different organs involved in the formulation of the budget are:

The Finance Ministry It has the overall responsibility for the formulation of the budget, and provides the required leadership and direction.

The Administrative Ministries They have a detailed knowledge of administrative requirements.

The Planning Commission It facilitates the incorporation of plan priorities in the budget. In other words, the Finance Ministry remains in close touch with the Planning Commission in order to incorporate the plan priorities in the budget.

The Comptroller and Auditor-General He provides the accounting skills which are necessary for the formulation of the budget estimates.

Stages/Process

The various stages involved in the formulation of the budget are explained below:

Preparation of Estimates by the Drawing and Disbursing Officers In September—October (i.e. 5–6 months before the commencement of the financial year), the Finance Ministry dispatches circulars and forms to Administrative Ministry inviting their estimates of expenditure for the ensuing financial year. The Administrative Ministry in turn pass on these forms (in which the estimates and other requisite information have to be filled in) to their local/field offices, that is, to the disbursing officers. Each such form contains the following columns:

- Actual figures of the previous year
- Sanctioned budget estimates for the current year
- Revised estimates of the current year
- Proposed estimates for the next year (with explanation for any increase or decrease)
- Actuals of the current year available (at the time of preparation of the estimates)
- Actuals for the corresponding period of the previous year

Scrutiny and Consolidation of Estimates by the Departments and Ministries Head of the department, after receiving the estimates from the drawing officers, scrutinises and consolidates them for the entire department and submits them to the Administrative Ministry.

The Administrative Ministry also scrutinises the estimates in the light of its general policy and consolidates them for the whole ministry and submits them to the Finance Ministry (Budget Division of the Department of Economic Affairs).

Scrutiny by the Finance Ministry The Finance Ministry scrutinises the estimates received from the Administrative Ministry from the point of view of economy of expenditure and availability of revenues. Its scrutiny is nominal in case of ‘standing charges’ and more exacting in case of ‘new items’ of expenditure.

Settlement of Disputes If there is a difference of opinion between the Administrative Ministry and the Finance Ministry on the inclusion of a scheme in the budget estimates, the former can submit such estimates to the Union Cabinet. The decision of the Cabinet in this regard is final.

Consolidation by the Finance Ministry After this, the Finance Ministry consolidates the budget estimates on the expenditure side. Based on the estimated expenditure, the Finance Ministry prepares the estimates of revenue in consultation with the Central Board of Direct Taxes and the Central Board of Indirect Taxes. It is also assisted in this regard by the Income Tax Department and the Central Excise and Customs Department.

Approval by the Cabinet The Finance Ministry places the consolidated budget before the Cabinet. After the approval of the Cabinet, the budget can be presented to the Parliament. It must be mentioned here that the budget is a secret document and should not be leaked out before it is presented to the Parliament.

ENACTMENT OF BUDGET

'Enactment of budget' means the passage or approval of the budget (i.e. the annual financial statement or the statement of the estimated receipts and expenditure of the Government of India in respect of each financial year) by the Parliament and ratification by the President. This legalises the receipts and expenditure of the government. This means that the government can neither collect money nor spend money without the enactment of the budget.

Stages in Enactment

The budget goes through the following six stages in the Parliament:

- Presentation of budget
- General discussion
- Scrutiny by departmental committees
- Voting on demands for grants
- Passing of Appropriation Bill
- Passing of Finance Bill

Presentation of Budget Rule 213 of the Lok Sabha provides for the presentation of the budget to the Lok Sabha in two or more parts, and when such presentation takes place, each part shall be dealt with in the manner as if it were the budget. Accordingly, the budget is presented in two parts—Railway Budget and General Budget. Both are governed by the same procedure.

The introduction of Railway Budget precedes that of the General Budget. While the former is presented to the Lok Sabha by the Railway Minister in the third week of February, the latter is presented to the Lok Sabha by the Finance Minister on the last working day of February.

The Finance Minister presents the General Budget with a speech known as the 'budget speech'. At the end of the budget speech in the Lok Sabha, the budget is laid before the Rajya Sabha which can only discuss it and has no power to vote on the demand for grants.

The documents that are also presented to the Lok Sabha along with the budget are:

- An explanatory memorandum on the budget
- An Appropriation Bill
- A Finance Bill containing the taxation proposals
- Annual reports of the ministries
- Economic classification of the budget

Earlier, the economic survey report prepared by the Finance Ministry also used to be presented to the Lok Sabha along with the budget. Now, it is presented a few days before the presentation of the budget.

General Discussion The general discussion on budget begins a few days after its presentation. It takes place in both the houses of Parliament and lasts usually for three to four days. It is a British legacy.

During this stage, the Lok Sabha can discuss the budget as a whole or on any question of principle involved therein but no cut motion shall be moved nor shall the budget be submitted to the vote of the House. The Finance Minister shall have a general right of reply at the end of the discussion.

Scrutiny by Departmental Committees After the general discussion on the budget is over, the Houses are adjourned for about three to four weeks. During this gap period, the 24 departmental standing committees of the Parliament examine and discuss in detail the demands for grants of the concerned ministries and prepare reports on them. These reports are submitted to both the Houses of Parliament for consideration.

The standing committee system established is 1993 makes parliamentary financial control over the ministries much more detailed, close, in-depth and comprehensive.

Voting on Demands for Grants In the light of the reports of the departmental standing committees, the Lok Sabha takes up voting of demands for grants. The demands are presented ministrywise. A demand becomes a grant after it has been duly voted.

Two points should be noted in this context. One, the voting of demands for grants is the exclusive privilege of the Lok Sabha, that is, the Rajya Sabha has no power of voting the demands. Second, the voting is confined to the votable part of the budget—the expenditure charged on the Consolidated Fund of India is not submitted to the vote (it can only be discussed).

While the General Budget has totally 109 demands (103 for civil expenditure and 6 for defence expenditure), the Railway Budget has 32 demands. Each demand is voted separately by the Lok Sabha. During this stage, the members of Parliament can discuss the details of the budget. They can also move motions to reduce any demand for grant. Such motions are called as 'cut motions' which are of three kinds:

Disapproval of Policy Cut Motion It represents the disapproval of the policy underlying the demand. It states that the amount of the demand be reduced to ` 1. The members can also advocate an alternative policy.

Economy Cut Motion It represents the economy that can be affected in the proposed expenditure. It states that the amount of the demand be reduced by a specified amount (which may be either a lumpsum reduction in the demand or omission or reduction of an item in the demand).

Token Cut Motion It ventilates a specific grievance which is within the sphere of responsibility of the Government of India. It states that the amount of the demand be reduced by ` 100.

The significance of a cut motion lies in two things:

(a) It facilitates the initiation of concentrated discussion on a specific demand for grant; and
(b) It upholds the principle of responsible government by probing the activities of the government.

However, the cut motions do not have much utility in practice. They are only moved and discussed in the house but not passed as the government enjoys majority support. Their passage by the Lok

Sabha amounts to the expression of want of parliamentary confidence in the government and may lead to its resignation.

In total, 26 days are allotted for the voting of demands. On the last day (i.e. 26th day) the Speaker puts all the remaining demands to vote and disposes them whether they have been discussed by the members or not. This is called as 'Guillotine'.

Passing of Appropriation Bill The Constitution states that "no money shall be withdrawn from the Consolidated Fund of India except under appropriation made by law." Accordingly, an Appropriation Bill is introduced to provide for the appropriation out of the Consolidated Fund of India all money required to meet:

(i) The grants voted by the Lok Sabha.
(ii) The expenditure charged on the Consolidated Fund of India.

No such amendment can be proposed to the Appropriation Bill in either house of the Parliament which will have the effect of varying the amount or altering the destination of any grant voted, or of varying the amount of any expenditure charged on the Consolidated Fund of India.

The Appropriation Bill becomes the Appropriation Act after it is assented to by the President. This Act authorises (or legalises) the payments from the Consolidated Fund of India. This means that the Government cannot withdraw money from the Consolidated Fund of India till the enactment of the Appropriation Bill. This takes time and usually goes on till the end of April. But the government needs money to carry on its normal activities after 31st March (the end of the financial year). To overcome this functional difficulty, the Constitution has authorised the Lok Sabha to make any grant in advance in respect to the estimated expenditure for a part of the financial year, pending the completion of the voting of the demands for grants and the enactment of the Appropriation Bill. This provision is known as the 'Vote on Account'. It is passed (or granted) after the general discussion on budget is over. It is generally granted for two months for an amount equivalent to one-sixth of the total estimation.

Passing of Finance Bill Under Rule 219 of the Lok Sabha, the '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. It is subjected to all the conditions applicable to a Money Bill. Unlike the Appropriation Bill, the amendments (seeking to reject or reduce a tax) can be moved in the case of Finance Bill.

According to the Provisional Collection of Taxes Act of 1931, the Finance Bill must be enacted (i.e. passed by the Parliament and assented to by the President) within 75 days.

The Finance Act legalises the income side of the budget and completes the process of the enactment of the budget.

EXECUTION OF BUDGET

'Execution of budget' means the enforcement or implementation of the budget after its enactment by the Parliament. In other words, it means the implementation of the Appropriation Act (dealing with the expenditure) and the Finance Act (dealing with the revenue).

The budget is executed by various administrative ministries/departments under the overall control and direction of the Finance Ministry. In other words, the overall responsibility regarding the execution of the budget lies with the Finance Ministry—the central financial agency of the Government of India.

Expenditure Part

The financial control exercised by the Finance Ministry has been very tight due to the excessive concentration of financial authority in it. However, this control has been relaxed in course of time through various schemes of delegation of powers by which the administrative ministries are granted some operational freedom and flexibility in managing their expenditure.

The Finance Ministry controls the expenditure of administrative ministries/departments in the following ways:

(i) Approval of policies and programmes in principle.
(ii) Acceptance of provision in the budget estimates.
(iii) Sanctioning expenditure, subject to the powers which are delegated to the spending authorities (i.e. ministries).
(iv) Providing financial advice through the Integrated Financial Advisor.
(v) Reappropriation of grants (i.e. transfer of funds from one subhead to another).
(vi) Internal audit system.
(vii) Prescribing a financial code to be followed by the spending authorities.

The composition of the machinery devised by the executive government for discharging its responsibility is:

(i) A system of controlling officers (i.e. usually the head of the ministry/department).
(ii) A system of competent authorities who issue financial sanctions.
(iii) A system of drawing and disbursing officers.
(iv) A system of payments and accounts (pay and accounts offices are created in various departments of the Central Government to make payments and compile accounts).

Reappropriation, which is an executive act, requires the formal approval of the Finance Ministry or the Administrative Ministry/Department to which the required powers are delegated. Reappropriation is permissible within the same grant only and is not permissible in the following cases:

(i) As between voted and charged items of expenditures.
(ii) To meet the expenditure on a new service not provided for in the budget.
(iii) As between different grants voted by the Lok Sabha.
(iv) To meet any expenditure which was not sanctioned by the Lok Sabha or any other competent authority.
(v) To meet any expenditure which involves outlay in the future financial year (except the contingent expenditure)
(vi) As between the revenue and the capital parts of the budget.

The scheme of Integrated Financial Advisor was introduced first in the Ministry of Shipping and Transport in 1974 on an experimental basis and then extended to all the ministries of the Central Government during 1975–1976. Under this scheme, the Integrated Financial Advisors are appointed in the administrative ministries.

The Integrated Financial Advisor is of the rank of Joint Secretary or Additional Secretary. He is selected jointly by the Administrative Ministry and Finance Ministry and his confidential report is written jointly by both the ministries. He is under the dual control of both the ministries and also answerable to both. He assists the Administrative Ministry in the exercise of enhanced delegated financial powers and his advice can be overruled by the Secretary of the Ministry (in the case of delegated powers and functions). But outside the scope of delegated powers, he functions under the general direction of the Finance Ministry and has direct access to the Finance Secretary. He has the following powers and functions:

(i) Preparation of the budget.

(ii) Scrutiny of projects and programmes for the approval of Finance Ministry.

(iii) Post-budget vigilance.

(iv) Formulation of performance budget of the ministry and monitoring of the progress of schemes.

(v) Assisting the Secretary in discharge of his responsibility as the chief accounting authority of the ministry.

Revenue Part

Execution of the budget on the revenue side involves proper (a) collection of revenues; (b) custody of the collected funds; and (c) distribution of funds.

The collection of revenues involves the following stages:

(i) Devising a suitable machinery for tax administration and determination of procedure.

(ii) Assessment of tax, that is, preparation of a list of persons liable to pay tax and determining the amount to be paid by them.

(iii) Making provisions for hearing of objections and appeals.

(iv) Collection, that is, realisation of the amount due from the various assessees.

(v) Following up and realisation of arrears, that is, dealing with the defaulters.

The Department of Revenue of the Finance Ministry exercises overall control and supervision over the machinery charged with the collection of taxes through the Central Board of Direct Taxes and the Central Board of Excise and Customs.

The Reserve Bank of India, the State Bank of India, the district treasuries (about 300) and sub-treasuries (about 1,200) are engaged in the custody and distribution of funds. The Constitution of India provides for the following three kinds of funds for the Central Government:

(i) Consolidated Fund of India (Article 266)

(ii) Public Account of India (Article 266)

(iii) Contingency Fund of India (Article 267)

DEFICIT FINANCING

The various sources of funds to finance economic development in the modern states are (i) taxation, (ii) public borrowing, (iii) government savings, (iv) surplus of public enterprises, (v) deficit financing, and (vi) external assistance.

When the government cannot raise sufficient resources through taxation, public borrowing and so on, it resorts to deficit financing to meet its development expenditure.

Meaning

Deficit financing, in general, refers to any public expenditure that is in excess of current public revenue.

In the Western countries and the USA, the term 'deficit financing' is used in a wider sense while, in India, it is used in a narrower sense.

In the Western countries and the USA, government expenditure financed through public borrowings (i.e. from people, commercial banks, and the Central Bank) are included in deficit financing.

In India, on the other hand, government expenditure financed through borrowing from people and commercial banks are excluded from deficit financing. These are known as market borrowings.

According to the Planning Commission, deficit financing in India includes:

(i) withdrawal of past accumulated cash balances by the government;
(ii) borrowing from the Central Bank, that is, the Reserve Bank of India; and
(iii) Issuing of new currency.

As observed by Misra and Puri, "when government borrows from the Reserve Bank of India, it merely transfers its securities to the Bank which, on the basis of these securities, issues more notes and puts them into circulation on behalf of the government. This accounts to creation of money".

In short, the deficit financing in the Indian context connotes direct increase in money supply through the issue of fresh currency by the government in order to meet the budget deficit.

Concepts

The Government of India recognises five concepts of deficit financing. They are:

1. Revenue Deficit When revenue expenditure of the government is more than its revenue receipts, it is known as revenue deficit. The revenue expenditure of the government comprises the resources spent on those items which do not create assets like expenditure on civil administration, defence, law and order, justice, interest payment, subsidies and so on. The revenue receipts of the government includes tax revenues and non-tax revenues.

2. Budget Deficit When the total expenditure of the government is more than its total receipts, it is known as budget deficit or overall budgetary deficit. The total expenditure of the government includes both revenue expenditure and capital expenditure. Similarly, the total receipts of the government includes both revenue receipts and capital receipts.

3. Fiscal Deficit Since 1950, the Government recognised the above two concepts of deficit. Later in 1986, the third concept of deficit, called fiscal deficit, was introduced on the recommendation of the Sukhmoy Chakravarty Committee (1982–1985) on the Review of the Working of the Monetary System in India. The fiscal deficit refers to budgetary deficit plus market borrowings and other liabilities of the government. It measures the total borrowing requirements of the government from both internal and external sources.

4. Primary Deficit It indicates the fiscal deficit minus amount of interest paid by the government. It is also known as non-interest deficit. This concept of deficit was introduced recently.

5. Monetised Deficit The budget deficit can be financed in two ways: either by borrowing from the public or by borrowing from the Reserve Bank of India (RBI). When it is financed through borrowing from the RBI, it is called Monetised Deficit. In other words, it is increase in the net RBI credit to the Government.

Role

Modern states have resorted to deficit financing under three different circumstances:

1. Depression The developed countries of Europe and USA resorted to deficit financing during the great depression of 1930s to deal with the problem of mass unemployment. It was J.M. Keynes who suggested the logic of deficit financing to fight cyclical depressions in capitalist countries and to eliminate mass unemployment. He opined that the main cause of unemployment in a developed country is lack of effective demand (for goods) which depends on the propensity for consumption. To overcome this problem, Keynes suggested deficit financing to finance public works projects. In case public works are not available, the governments should, according to Keynes, ask people to "dig wells and fill wells". This increases the purchasing power of people and results in effective demand for goods. This further increases employment which again increases effective demand and hence employment and so on. Keynes called it "multiplier effect". In this way, the economy can be revived and lifted from the morass of depression.

2. Economic Development The developing countries including India have resorted to deficit financing for financing economic development. This is because, these countries do not have sufficient resources to finance public investment to accelerate the process of development. The deficit financing helps rapid capital formation for economic development. It breaks bottlenecks and structural rigidities in the economy and thereby increases productivity. Thus, it provides stimulus to economic development by financing investment, employment and output in the economy. However, it has a negative effect on the economy, that is, inflationary rise in prices of goods and services. This is because, the deficit financing increases the supply of money in the economy without a corresponding increase in supply of goods and services. This inflationary character of deficit financing changes the pattern of investment by people, results in forced savings, adversely affects balance of payments, increases economic inequalities, increases credit creation by banks and so on.

3. War The modern states have also resorted to deficit financing to finance war operations. The financial resources raised by the governments through taxation and borrowing do not suffice to meet the cost of war. Hence, the governments have no alternative except to create new money by printing more currency. This war deficit financing brings in circulation a large quantity of money in the economy. This increases the monetary incomes and demand for goods. Such a situation results in inflation due to absence of corresponding increase in supply of goods.

Safe Limit

Deficit financing is a necessary evil. On the one hand, it is essential for economic development and on the other hand, it is intrinsically inflationary in nature. Hence, it should be kept within the safe limit so that it leads to capital formation without inflationary rise in prices. The various factors which determine the safe limit of deficit financing (or the measures needed to keep the deficit financing within safe limit) are as follows:

1. Effective efforts should be made to mop up surplus money by higher taxation and increased loans.
2. The quantity of money injected into the economy should be to the extent of the rate of growth of the economy.
3. The newly created money should be used for productive purposes like irrigation, industrial development and so on.
4. The deficit-inducted additional money should be used for the promotion of those projects which have short gestation period. This will increase the supply of goods quickly and thus check the price rise.
5. Efforts should be made to transfer the non-monetised sector (barter part of the economy) into the monetised sector.
6. There should be an effective regulation of prices of goods and distribution of goods through rationing.
7. The import of capital equipment, industrial raw material and food grains should be encouraged and that of luxury and semi-luxury goods should be discouraged.
8. The people should have the spirit of sacrifice and extend their cooperation in the implementation of the policies for reducing the price effect of deficit financing for capital formation.
9. The government should offer incentives to increase production in private sector.
10. Credit creation policies should be integrated with deficit financing to regulate the increased credit creation by banks.

PUBLIC DEBT

Meaning

Public debt is an instrument of resource mobilisation by the modern government. The revenue raised through taxation and other sources is not sufficient to meet the increased expenditure of the government. Revenue from taxation cannot be raised beyond a certain limit while, the deficit financing becomes inflationary when it crosses the safe limit. Hence the government has to resort to public debt to accelerate the process of development.

Public debt denotes borrowing by the government from the people, banks, financial institutions and so on. It is the debt incurred by the government in mobilising resources in the form of loans, which are to be repaid at a future date with interest.

Classification

Public debt is classified in the following ways:

1. Internal and External When the government borrows within the country, it is called internal debt. When the government, on the other hand, borrows from outside the country, it is called external debt. Internally, the government borrows from individuals, business establishments, financial institutions, commercial banks, and central bank. Externally, it borrows from foreigners, foreign banks, foreign governments, and international institutions. Unlike internal debt, external debt involves material loss to the debtor country.

2. Voluntary and Compulsory When the government borrows by issuing securities to which people are free to subscribe, it is called voluntary debt. When the government, on the other hand, enforces borrowing through legal compulsion, it is called compulsory debt. Generally, public debts are voluntary in nature. The government resorts to compulsory loan under extraordinary circumstances like war, famine, or to curb inflation.

3. Productive and Unproductive Productive debt is one which is incurred for those projects which yield income to the government. For example, the debt incurred to meet expenditure on power projects, irrigation projects, public enterprises, and railways. The income derived from these assets is used to pay the interest and the principal of the debt. Unproductive debt, on the other hand, is one which neither yields any income to the government nor creates any asset. For example, debt incurred to cover any budgetary deficit or to finance war, earthquake, famine and drought. Hicks called these two types of debts as active debt and dead weight debt respectively.

4. Funded and Unfunded Funded debt is a long-term debt, payable after a year, while unfunded debt is a short-term debt, payable within a year. The former is incurred to create a permanent asset, whereas the latter is incurred to meet temporary gap in budget. Unfunded debt is also known as floating debt and includes treasury bills, ways and means advances from central bank and so on.

5. Redeemable and Irredeemable When the government borrows money with a promise to pay off in future at a specified date, it is known as redeemable debt. When the government, on the other hand, borrows without any intention to repay the same in future, it is known as irredeemable debt. However, the government continues to pay the interest on such loans. The redeemable and irredeemable debts are also known as terminable and perpetual debts.

A situation in which borrowings have to be resorted to just keep up with the servicing of debt is known as ‘debt trap’. Debt servicing denotes payment of interest on debts as well as repayment of instalments of debts. The debt trap could be both internal and external.

Redemption

Redemption of public debt means repayment of public debt. There are various methods of redemption of public debt:

1. Refunding In this method, the government issues new bonds and securities in order to repay the matured loans. In other words, matured or old debts are replaced by new debts. Hence, the money burden of the debt is not relinquished. Rather, it is accumulated due to the postponement of debt repayment.

2. Terminable Annuities In this method, public debt is repaid in equal instalments. The government repays a part of the debt every year by issuing terminable annuities. Thus, the debt goes on diminishing annually and finally it vanishes.

3. Conversion When the rate of interest falls, the government converts the old loan into a new loan and thus reduces its interest payments. It may be compulsory or voluntary. Unlike refunding, conversion involves changes in terms of loan including rate of interest. Dalton called this conversion process a 'Partial repudiation.'

4. Sinking Fund It connotes a 'debt redemption fund'. It involves the creation and the gradual accumulation of a separate fund by the government every year from its revenues to repay the debt. Although, it is the most systematic method of redemption, it is a slow process and the government may encroach upon it during a financial crisis.

5. New Taxation In this method, the government imposes new taxes and raises money for the repayment of old debts. It transfers the resources from tax-payers to the bond holders and thus causes redistribution of income and wealth in the community.

6. Capital Levy It connotes a special 'redemption levy'. Under this method, there will be single but very heavy taxation on the property and wealth of individuals; levied once for all for the clearance of the debt. It is usually levied after a war to repay the unproductive war debts. Its merit is that the country is thereby freed from the burden of interest payment in future.

7. Surplus Budget Under the surplus budget (income exceeding expenditure), the government is left with some money which can be used for the clearance of debts. A surplus budget can be realised in two ways: (a) through heavy taxation, or (b) through reduction in government expenditure.

8. Surplus BOP The repayment of external debt requires a surplus balance of payments (BOP). Hence, the government should accumulate the necessary foreign exchange by creating export surplus and by reducing imports. Temporarily, the external debt can be repaid through the floating of new external loans.

9. Currency Expansion Under this method, the government prints more currency to repay the debts. This results in inflation and destroys the value of fixed money claims. This method was used by Germany after the First World War (1914–1918).

10. Repudiation In this method, the government refuses to pay the interest or principal or both. In other words, the government does not recognise its obligation to repay the loans taken by it. In 1917, USSR repudiated all its debts, both internal and external.

ACCOUNTS AND AUDIT

Meaning of Accounts

The term 'Accounts' is defined as "Statements of facts relating to money or things having money value." The facts which are incorporated in the records of accounts are called 'transactions'. Thus, accounting means keeping a systematic record of financial transactions. It involves the collection, recording, classifying and summarising transactions of a financial nature and interpreting the results thereof.

Accounting has three purposes— (i) the determination of the fidelity of those handling funds; (ii) the furnishing of information regarding financial conditions and operations for policy-making and administrative purposes; and (iii) the keeping of expenditure within the budgetary provisions and limitations.

Meaning of Audit

Audit is an important means of legislative control over financial administration. It is an instrument of enforcing accountability of administration to the legislature. It is a part of external control over administration.

Audit is an examination of the accounts in order to discover and report to the legislature the unauthorised, illegal or irregular expenditures and unsound financial practices on the part of administration. Its objective is to see that the expenditure is incurred with the sanctions of the competent authority, and made for the purpose for which it was sanctioned by the legislature.

The audit can be either post-audit or pre-audit. If the audit occurs after the money is spent, it is called post-audit. On the other hand, if the audit occurs before the money is spent or during the process of spending, it is referred to as pre-audit or concurrent audit.

Role of Audit

The following points highlight the role of audit in the modern state:

Regulatory Audit It is concerned with the legal and technical aspects of expenditure by the administration. It ensures the conformity of expenditure to laws, rules and regulations and sees that it is supported by adequate vouchers. Hence, it is also known as legal audit.

Propriety Audit It is concerned with the wisdom, faithfulness and economy of expenditure. It detects cases of extravagance and waste even when the expenditure is incurred according to laws, rules and regulations.

Performance Audit It is concerned with the appraisal of accomplishments. It measures the performance of administration against the expenditure incurred. Hence, it is also known as efficiency audit.

Separation of Accounts from Audit

Till 1976, accounting and auditing functions were combined in the office of the Comptroller and Auditor-General of India. In other words, he was responsible for both the compilation and maintenance of accounts as well as their auditing, not only with respects to the Central Government but also the state governments. This combined arrangement was a relic of the British rule and came to be criticised. Accordingly, the Inchcape Committee (1923), the Muddiman Committee (1924), the Simon Commission (1929), the Public Accounts Committee and the Estimates Committee recommended the separation of accounts from audit on following grounds.

(i) The separation would increase the efficiency of Audit Department as it will be relieved of accounting responsibilities and can concentrate on audit functions only.
(ii) The combined system has the inherent danger of frauds and embezzlements and prevent their coming to light.
(iii) The combination of the two functions in a single office is not appropriate as accounting is an

executive function while auditing is a quasi-parliamentary function.

(iv) The combined system requires the Comptroller and Auditor-General to audit the accounts which are compiled by himself. This places him in a highly embarrassing position and is against the practice of other modern governments which have separated the two functions.

(v) The separation makes the spending departments not to exceed the appropriations sanctioned by the Parliament as they are entrusted with the accounting responsibilities.

(vi) The separation would increase the independence of audit, as the combined system runs counter to the principle of independence of audit.

(vii) The entrustment of accounting responsibilities to the departments would not only improve the system of accounting but also make them responsible.

(viii) The separation of the two functions by entrusting the accounting responsibilities to executive departments not only facilitates close budgeting but also more effective formulation of revised estimates by them.

(ix) The separation facilitates use of accounting in decision-making and financial management.

Departmentalisation of Accounts

In 1976, the Central Government separated accounting from audit by adopting the new scheme of departmentalisation of accounts. The salient features of the scheme of departmentalised management accounting system are as follows:

(i) The Comptroller and Auditor-General of India was relieved of the responsibility of the compilation and maintenance of accounts of the Central Government and is now concerned with their auditing only. However, he continues to be responsible for the compilation and maintenance of accounts of the states which have not separated accounts from audit.

(ii) The administrative departments have taken over most of the payment and receipt functions from the treasuries. In other words, they have assumed responsibility for making payments and their accounting.

(iii) The Secretary of the ministry is designated as the chief accounting authority for all the transactions of the Ministry as well as its attached and subordinate offices. He is totally responsible for the working of the payment and accounting setup, and is also responsible for the certification of the monthly accounts. He discharges this responsibility through and with the assistance of the Integrated Financial Advisor of the Ministry.

(iv) The Integrated Financial Advisor is the head of the payment and accounting organisation of the ministry. On behalf of the chief accounting authority (i.e. Secretary of the Ministry), he is responsible for the following:

  (a) Formulation of the budget of the ministry and its departments.
  (b) Control of expenditure.
  (c) Arranging payments sanctioned by the ministry.
  (d) Consolidation of the accounts of the ministry as a whole.
  (e) Preparation of Appropriation Accounts for the grants controlled by the ministry.
  (f) Introduction of an efficient system of management best suited to the functional requirements of the ministry and its departments.
  (g) Internal audit of payments and accounts.
  (h) Ensuring accuracy of accounts and efficiency of operations.

In the performance of the above duties, the Integrated Financial Advisor is assisted by principal accounts officers, the heads of pay and accounts offices, the Chief Controller of Accounts, and the Controller of Accounts.

Controller General of Accounts

In 1976, a new office of the Controller General of Accounts was established as a part of the Department of Expenditure of the Ministry of Finance. He is to administer matters relating to the departmentalisation of accounts of the Central Government. He is the technical authority heading the new accounting setup of Central Government. He is responsible for the following:

(i) He prescribes general principles and form of accounts of Central as well as state governments and frames rules and manuals relating thereto.
(ii) He carries out the budget control, payments, receipt collection and accounting functions for the Central Government.
(iii) He provides regular feedback to the Finance Minister and other line ministries on the status of government finances.
(iv) He provides technical advice to all civil ministries and departments on various accounting matters. His advice is binding on them.
(v) He is responsible for disbursement and accounting of pension payments to government employees retiring from all civil ministries.
(vi) He conducts the internal audit of the expenditure incurred by the various ministries and departments of the Central Government to bring out the financial irregularities.
(vii) He is responsible for the evaluation and processing of proposals relating to the capital restructuring and disinvestments of various public sector undertakings of the Central Government. This job was entrusted to him in 1989.
(viii) He manages the cadre of the Indian Civil Accounts Service and the total accounts' personnel deployed in civil ministries and is responsible for the entire gamut of personnel management in relation to them.
(ix) He consolidates the monthly and annual accounts of the Central Government.
(x) He administers rules under Article 283 of the Constitution. This article deals with the custody and other aspects of Consolidated Fund, Contingency Fund and moneys credited to the Public Accounts.
(ix) He prepares a condensed form of the Appropriation Accounts and Finance Accounts of the Central Government. These, after getting audited by the Comptroller and Auditor-General of India, are placed before the Parliament by the President.

The Appropriation Accounts compare the actual expenditure under various grants with the amount of voted grants as specified in the Appropriation Act passed by the Parliament. On the other hand, the Finance Accounts shows (under the respective heads) the annual receipts and disbursements for the purposes of the Central Government.

Structure of Accounts

According to Article 150 of the Constitution, the form of the accounts of the Central and state governments is prescribed by the President of India on the advice of the Comptroller and Auditor-

General of India. Rule 204 of Lok Sabha states that the budget shall be presented to the Lok Sabha in such a form as the Finance Minister may (after considering the suggestions, if any, of the Estimates Committee) settle. In practice, the form of budget corresponds to the form of accounts.

The existing accounting practice could not meet the requirements of Performance Budgeting. Consequently, a revised accounting structure was introduced in 1974 by the Central Government to serve the objectives of management and the need of financial control and accountability.

In pursuance of this revised scheme, a five-tier classification of accounts has been adopted.

- Sectoral
- Major Head
- Minor Head
- Subhead
- Detailed Head

The sectoral classification has divided the functions of government into 3 sectors—General Services (with six subsectors), Social and Community Services, and Economic Services (with seven subsectors). In addition, there is a fourth sector, namely Grants-in-aid and Contributions.

The major head of account denotes a function of government (e.g. agriculture), while the minor head is assigned to a programme (e.g. agricultural farms). The subhead denotes the scheme covered by a programme and the detailed head represents the expenditure on the scheme in terms of inputs like salaries, investments, and so on.

In the new revised classification, the 'Object Head' (i.e. the object level of classification) has been retained and placed under the last tier. It provides item-wise control over expenditure.

The approval of the Comptroller and Auditor-General of India is required for any change in the major head.