



Government Budgets & Public Finance



by

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AGENDA

- Which Institutions are involved in the budget process?
- Coverage – Capital and revenue budgets
- Methods and practices
- Performance Budgeting
- Budget Preparation and approval
- Budget execution
- State and Central Budgets – an analysis

From 1947 to 2018...Budgets
Rs 192 cr to Rs 27,84,200 cr



What is a Budget?

- The word "Budget" derives its origin from the French word "Budgettee" which means a leather bag.
- Budget is basically a statement of government's resources and expenditure for a year.
- The Indian Constitution refers to the Budget as the 'Annual Financial Statement'.
- Budget is the instrument of the government to carry out its policies.

Constitutional Provisions

- Article 112 : mandatory to lay the Annual Financial Statement (Budget) before the Parliament
- Article 266: All the revenues and loans raised by the State to comprise the Consolidated Fund of the State.
- Article 113: To show expenditure charged on the Consolidated Fund separately.

Cash-based Budget

- Simple and amenable to expenditure control.
- Revenue directly linked to appropriations.

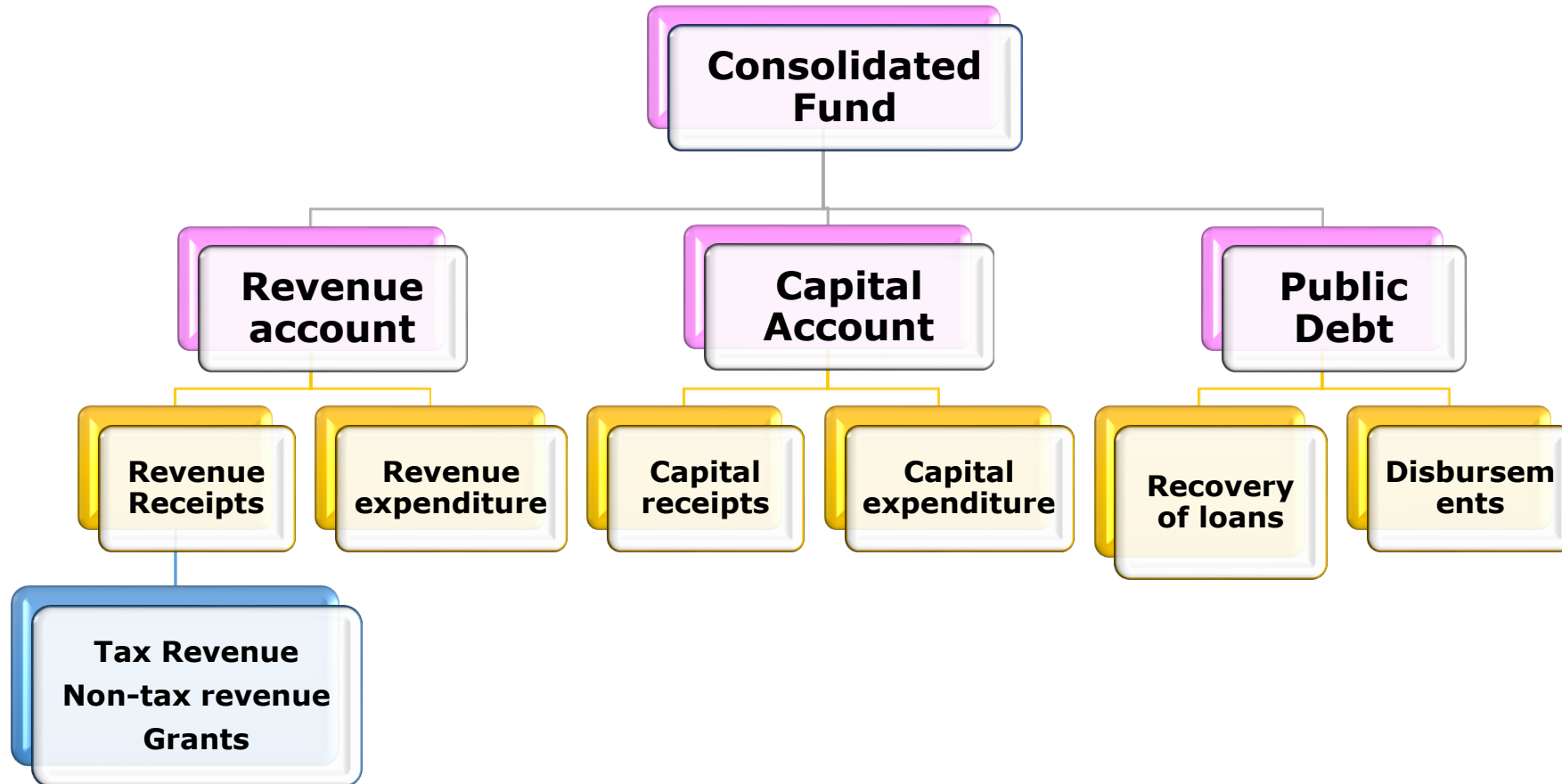
Shortcomings

- does not take into account revenue earned but not received and expenditure incurred but not paid.
- no provision for depreciation of assets.
- no measure of liabilities other than loans.

Structure of the Budget

- Structure follows the provisions of Articles 266 and 267 of the Constitution.
- As per these provisions all the moneys received and disbursed by the government should be organized into
 1. Consolidated Fund of the State
 2. Contingency Fund of the State
 3. Public Account

Consolidated Fund



Items charged to the Consolidated Fund

- Emoluments and allowances of the Governor, the Speaker and the Deputy Speaker and the High Court judges
- Debt servicing and discharge
- Expenditure required to satisfy court judgments and decrees and any other item declared by the Constitution or the State legislature to be so charged

Vote of the Legislature not required for charged Expenditure

Evolution of Accounting Classification

- Accounting system in India is over 150 years old.
- System of budget and accounts classification on a systematic basis was first introduced in the British India in 1938.
- Under Article 150 of the Constitution, C&AG lays down the form in which the accounts of the Union and the States have to be maintained.

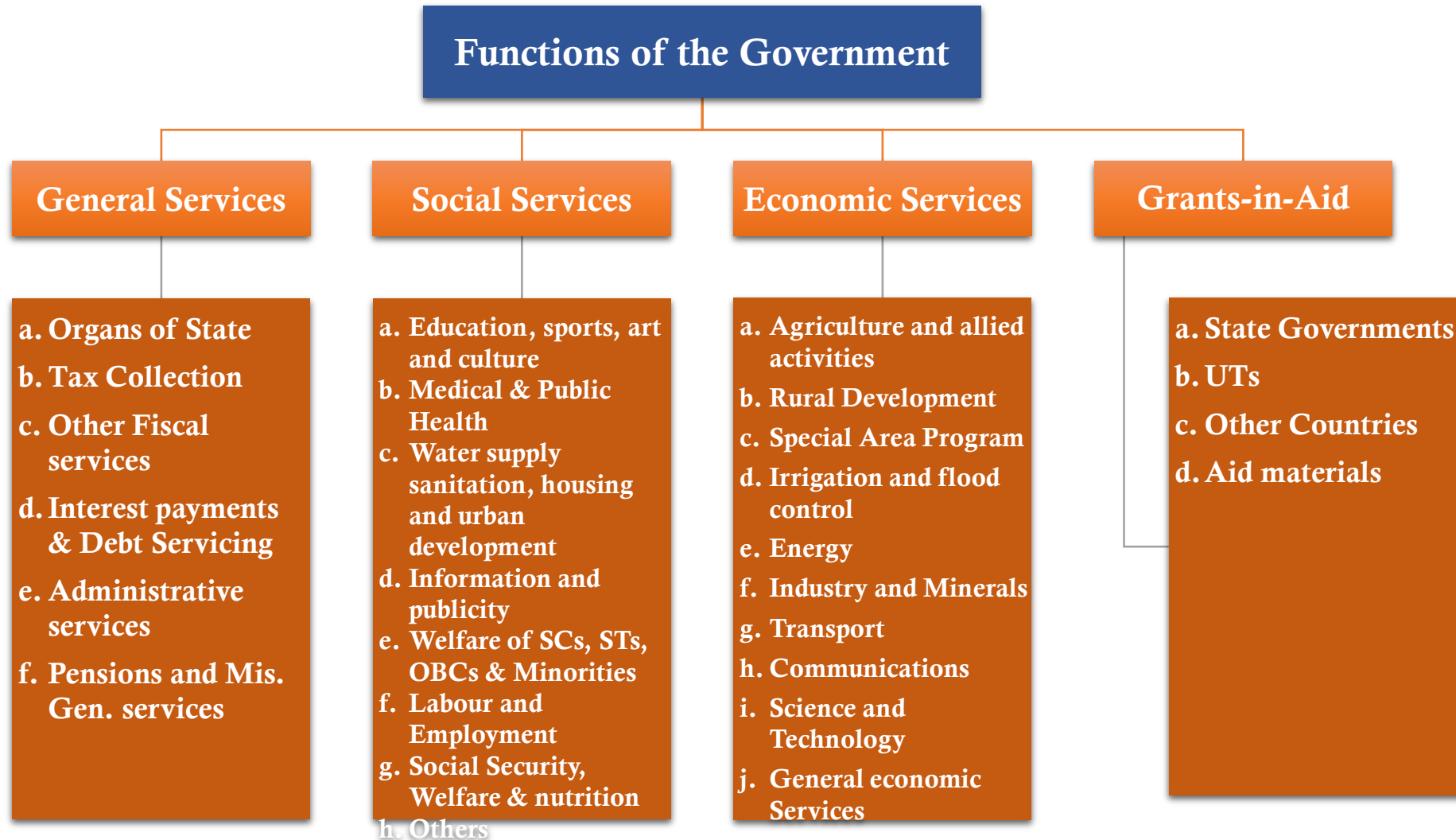
Revised Classification 1974

- Changes in budget and the accounting classification became necessary to reflect objectives of government spending
- The new system introduced in 1974 was based on government transactions on a function-cum-programme basis.

Changes in budget presentation 2017-18 onwards

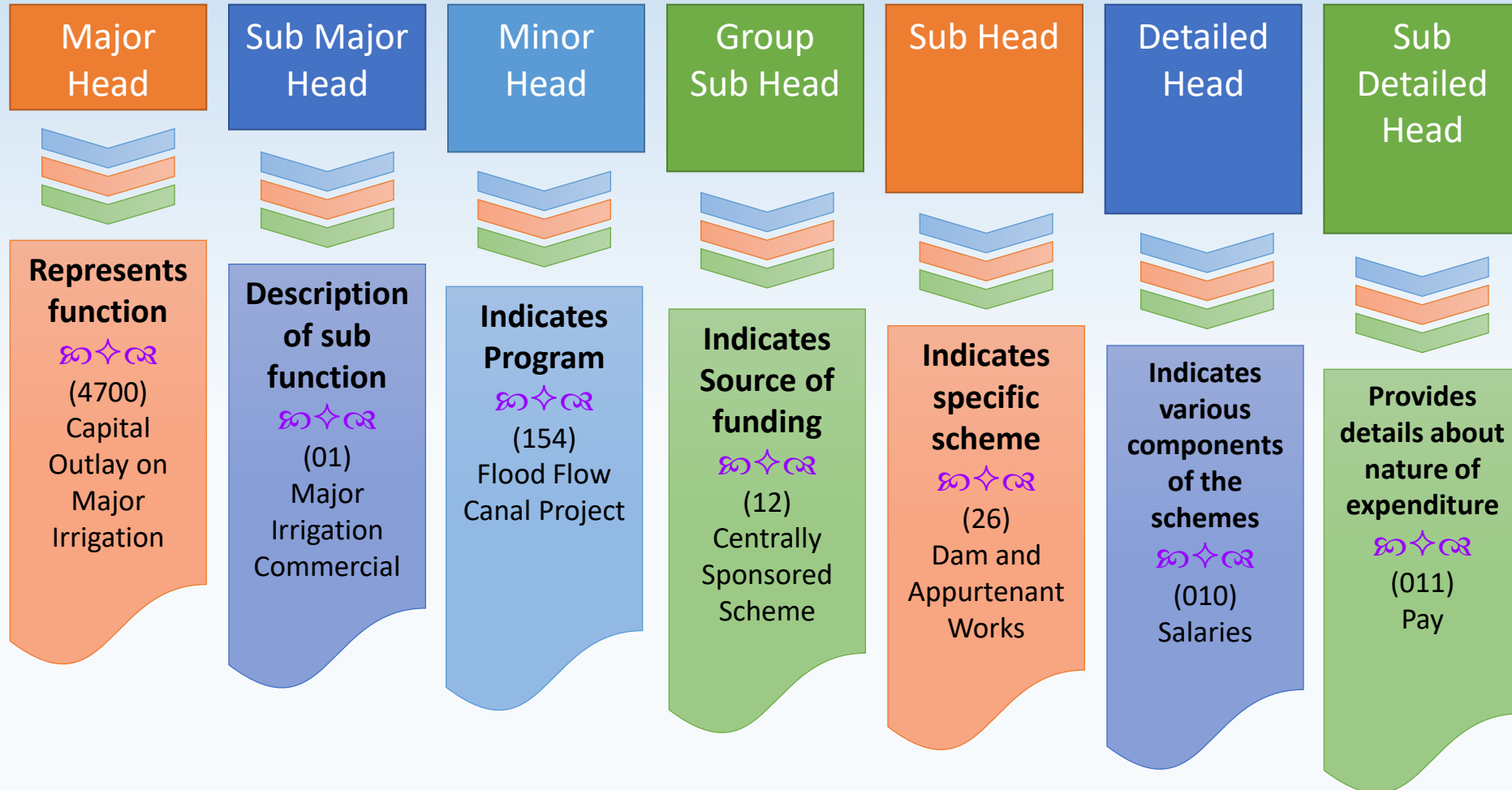
- With the removal of distinction of expenditure into Plan and Non-Plan and the replacement of the Planning Commission by NITI Aayog, classification of expenditure is now restricted to Capital and Revenue as mandated in the Constitution.
- With the setting up of the NITI Aayog, Annual Plans and Five Year Plans have been replaced by 15 year Vision, 7 years Strategy and 3 years Action Plans. Following this, the practice of State Annual Plans being approved by the Planning Commission is no more in vogue.

Broad Classification of Expenditure



Accounting Classification

Under each sector, such as General Services, Social Services, Economic Services, etc. accounts are classified under 7 standard tiers



■ **The 4 digit code allotted to a major head indicates, the nature of receipt or expenditure.**

1. Revenue Receipt Heads	:	0020 to 1999
2. Revenue Expenditure Heads	:	2011 to 3999
3. Capital Receipt Heads	:	4000
4. Capital Expenditure Heads	:	4001 to 5999
5. Public Debt Heads	:	6001 to 6004
6. Loans & Advances Heads	:	6075 to 8000
7. Public Account Heads	:	8001 to 8999

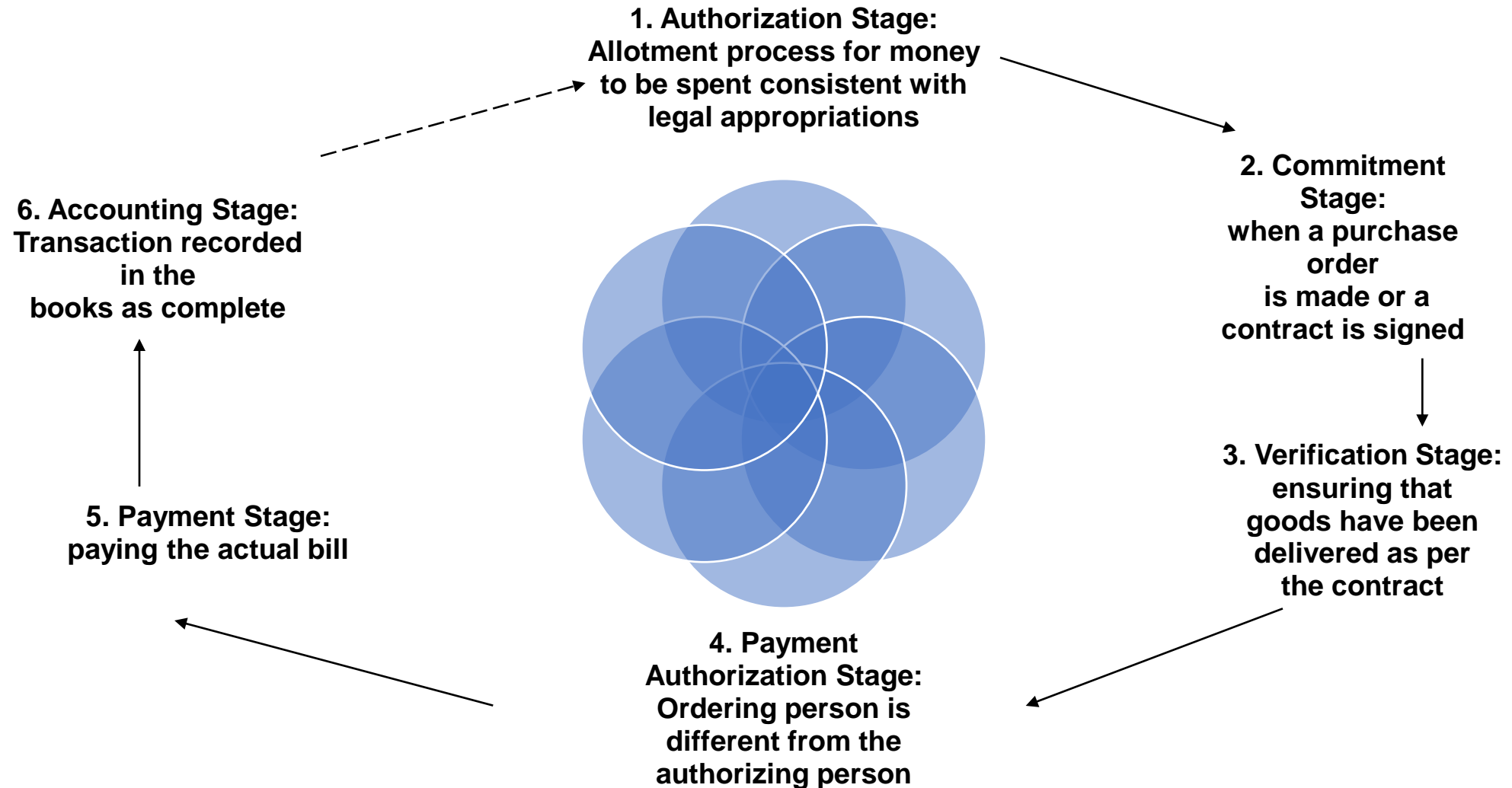
Union Budget

- [Budget at a glance 2019-20.pdf](#)
- [Receipts 2019-20.pdf](#)
- [transfer to states 2019-20.pdf](#)

Union Budget

- [Budget profile 2019-20.pdf](#)
- [Expenditure 2019-20.pdf](#)
- [Expenditure by head of account 2019-20.pdf](#)
- [Ministry wise Budget 2019-20.pdf](#)
- [Outlay on major schemes 2019-20.pdf](#)

The Budget Execution Process



Budget Process and institutions

- In democracies, voters delegate the power of public spending and taxes to elected politicians
- Two aspects are important
 1. Principal and agent problem - Elected politicians spend public monies on projects other than those public desires by extracting rents
 2. Common pool problem – Governments spend money drawn from a general tax pool on policies targeted at individual groups in the society leading to net benefits to these specific groups more than net benefits to society as a whole leading to excessive spending and deficits
- Budget processes and institutions are designed to overcome the above two problems

Budget and its coverage

- Fundamental requirement : the executive branch of Government can take no monies from public nor make any expenditure except with the explicit approval of the legislature
- Budget should reflect all components of good governance : accountability, transparency, participation and predictability
- The unitary principle that the budget represents all the revenues and expenditures of the Government is important or else it will not reflect the choices of society
- Or else programs can't be compared and state resources can't be allocated according to priorities

Budget : methods and practices

- Budgeting in public sector is a complex exercise and fragmentation is inevitable
- Spending agencies consider their own increases to be too small to affect the total significantly – common pool problem
- Information asymmetry and dysfunctional political processes are some of the main problems
- Strategy : SATISFICING – within the time limited budget process, incremental line item budgeting takes over
- The base of spending is taken as a given to each agency and focus of budget making is on marginal changes to the base
- All programs and activities of the previous year are rarely challenged

Budget : methods and practices

- Ills of line item incremental budgets
 1. Spending agencies pad budgets and finance ministries respond by effecting deep and often arbitrary expenditure cuts
 2. At the time of approval, the spending agencies often resort to underestimation so that once the program is approved the cost is revised during implementation
 3. Budgets are often spilt into development (capital) and recurring (revenue) budgets and much of the budget is focused on capital budgets whereas the bulk of the expenditure happens in the revenue budgets
- The outcome of incremental line item approach is unsustainable fiscal deficits and fiscal crises
- Improvements – in theory program budgeting, zero based budgets but in practice they made little difference

Budget Preparation and approval practices

- Objectives
 1. Control of expenditure
 2. Allocations to be in conformity of Government priorities &
 3. Operational efficiency
- Conditions
 1. A medium term perspective is needed
 2. Early decisions on hard choices and trade-offs
 3. Hard expenditure ceiling
- Failure on any of the three conditions, leads to incremental budgeting, dual budgeting and excessive bargaining
- Postponing until budget execution the hard choices between competing claims for resources makes them even harder and complicates program management

Budget Preparation and approval practices

- Starting point is preparation of consistent and public medium term macroeconomic framework showing the fiscal targets i.e. deficit, total expenditures, revenues etc., including the medium term fiscal perspective to prepare the annual budget
- Fiscal perspective covers three to five years and is updated yearly
- Estimates of expenditures over medium term should not be seen as entitlements i.e. they are not floors but the roof
- The medium term expenditure as well sector expenditure ceilings should be approved by top political leadership

Budget Preparation

- Process
 - Budget circular by Finance Ministry – giving guidelines for the preparation of ministry budgets and expenditure ceilings for each ministry
 - Ministries prepare the budget based on the circular
 - Budget discussions between the line ministry and the ministry of finance
 - Draft budget finalisation
- Three broad stages
 - Top down – the resources available to each ministry are communicated
 - Bottom up – the ministries prepare the spending proposals within the spending limits &
 - Iteration, negotiation and reconciliation to produce a draft budget that internally consistent and within the aggregate resources available

Fiscal responsibility laws – FRBM

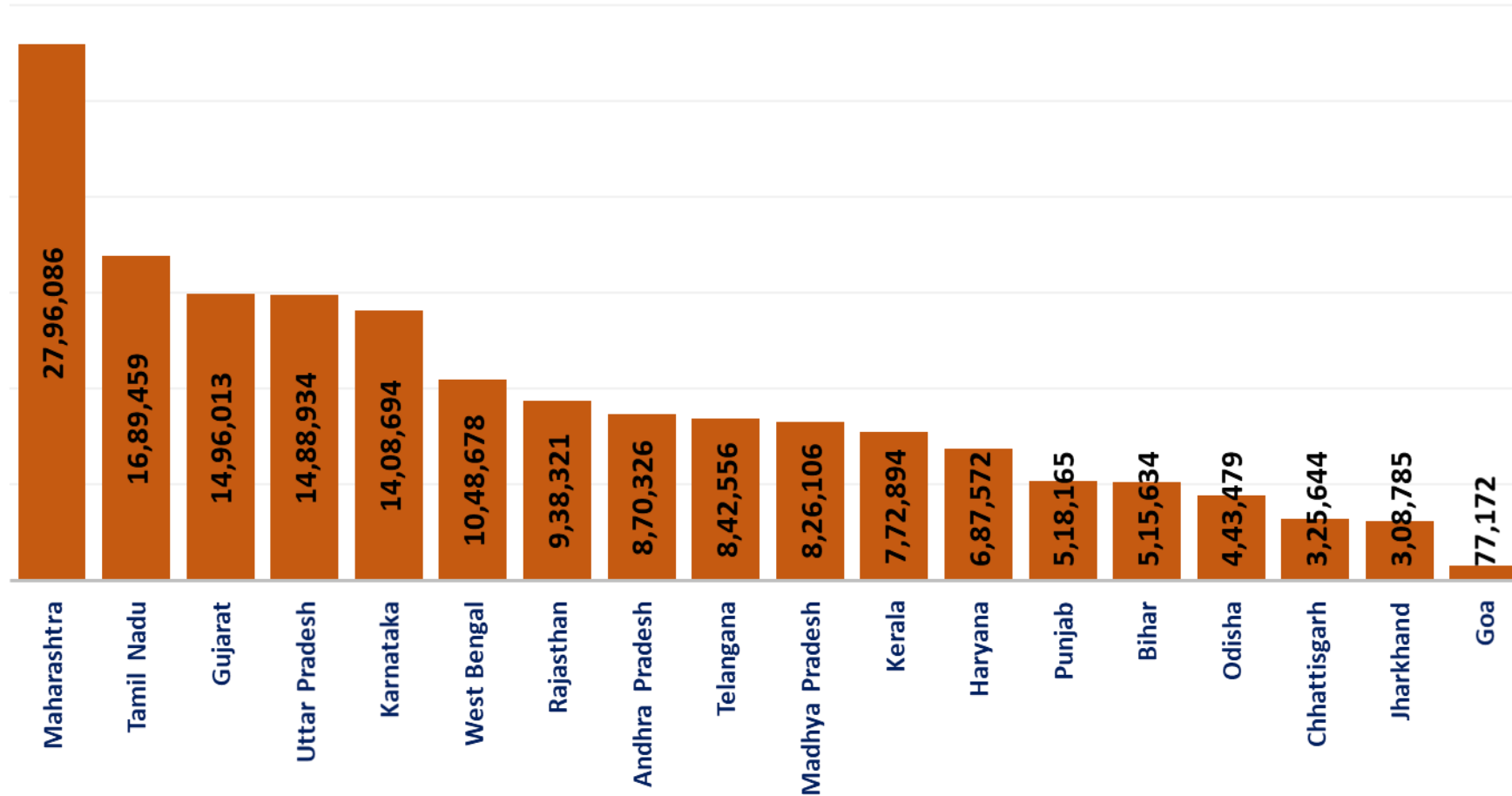
- Laws setting rigid limits on fiscal aggregates such as borrowing, fiscal deficit, guarantees etc.
- Golden rule – public borrowing should not exceed public investment
- Difficulty – these type of laws are a government contract with itself and thus are easy to violate or disregard
- They may limit wasteful expenditure in coalition governments or in sub national governments if the centre can provide effective enforcement

Budget approval by legislature

- Draft budget is presented to legislature for debate and approval
- Powers of legislature vary :
 - a) Unrestricted power to change both revenue and expenditure
 - b) Restricted to change revenue and expenditure within set limits
 - c) Balanced power to change revenue and expenditure with an accompanying measure to maintain the deficit targets
 - d) All major changes need approval of the legislature through supplementary budgets

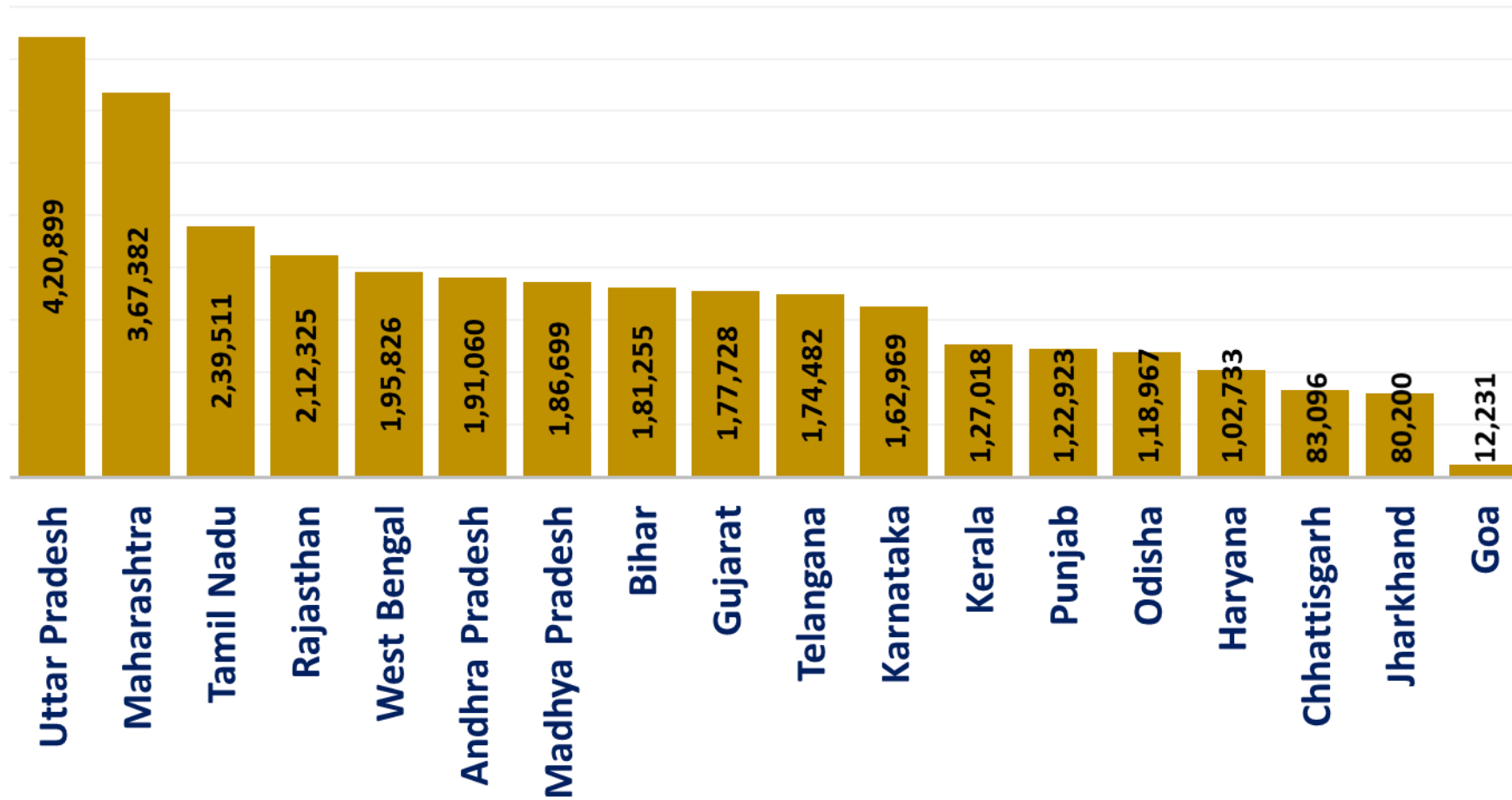
GSDP at Current Prices 2018-19 (Projected)

(Rs.in crore)



State Budget - 2018-19 (BE)

(Rs.in crore)

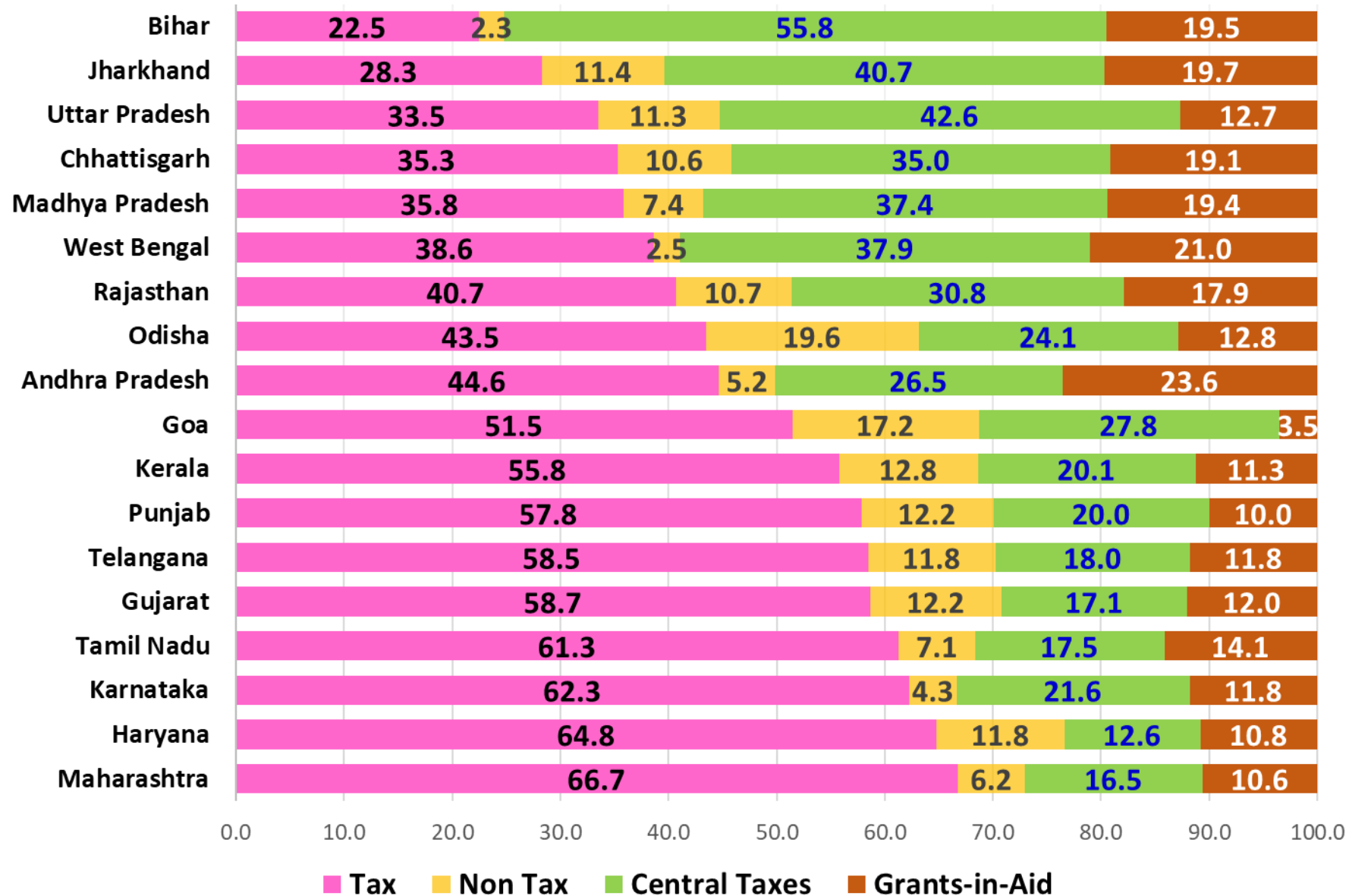


Horizontal Devolution Formula in the 13th and 14th Finance Commissions

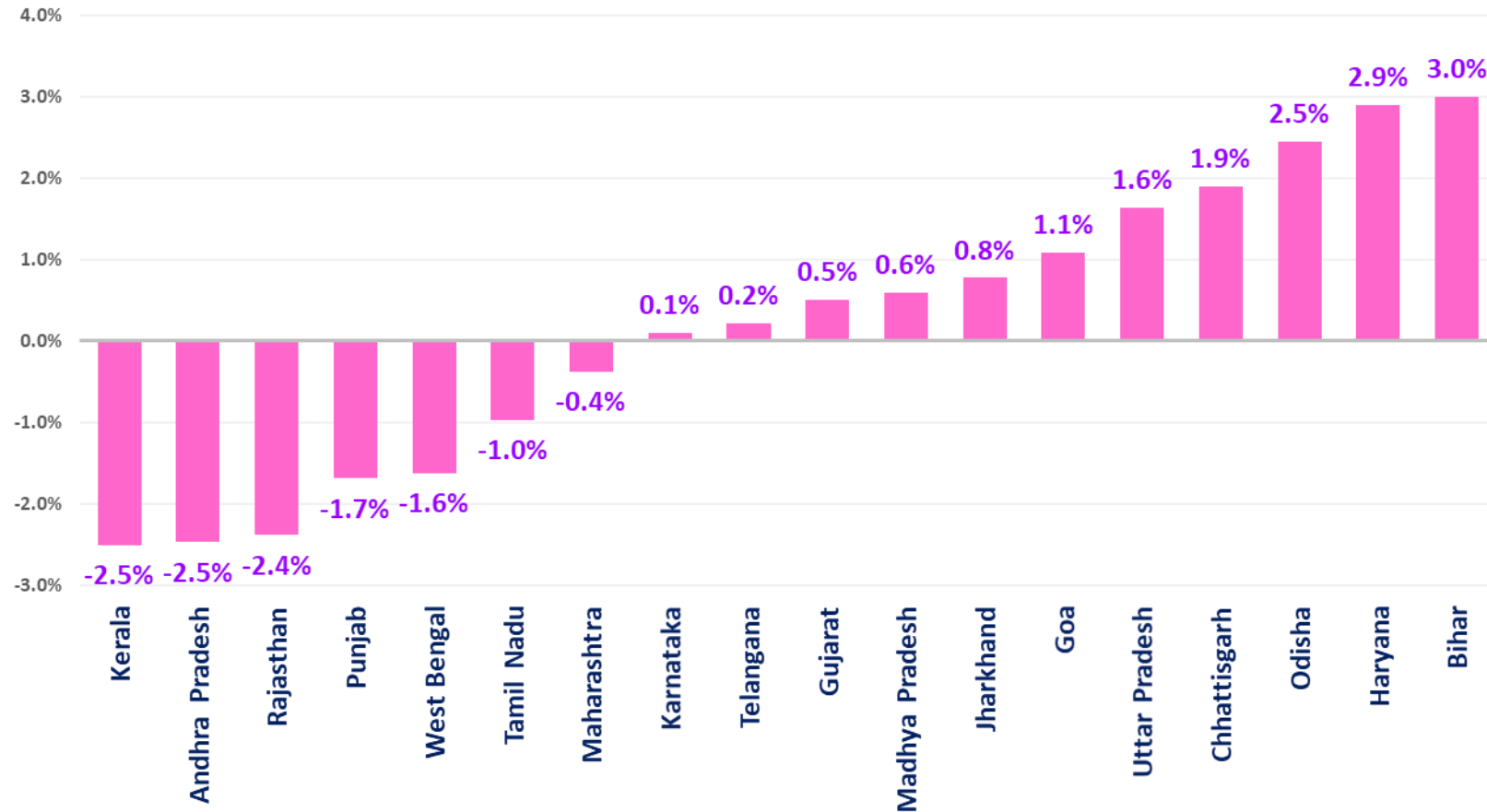
Variable	Weights accorded	
	13th	14th
Population (1971)	25.00%	17.50%
Population (2011)	0.00%	10.00%
Fiscal capacity/Income distance	47.50%	50.00%
Area	10.00%	15.00%
Forest Cover	0.00%	7.50%
Fiscal discipline	17.50%	0.00%
Total	100.00%	100.00%

Composition of Revenue Receipts (%)

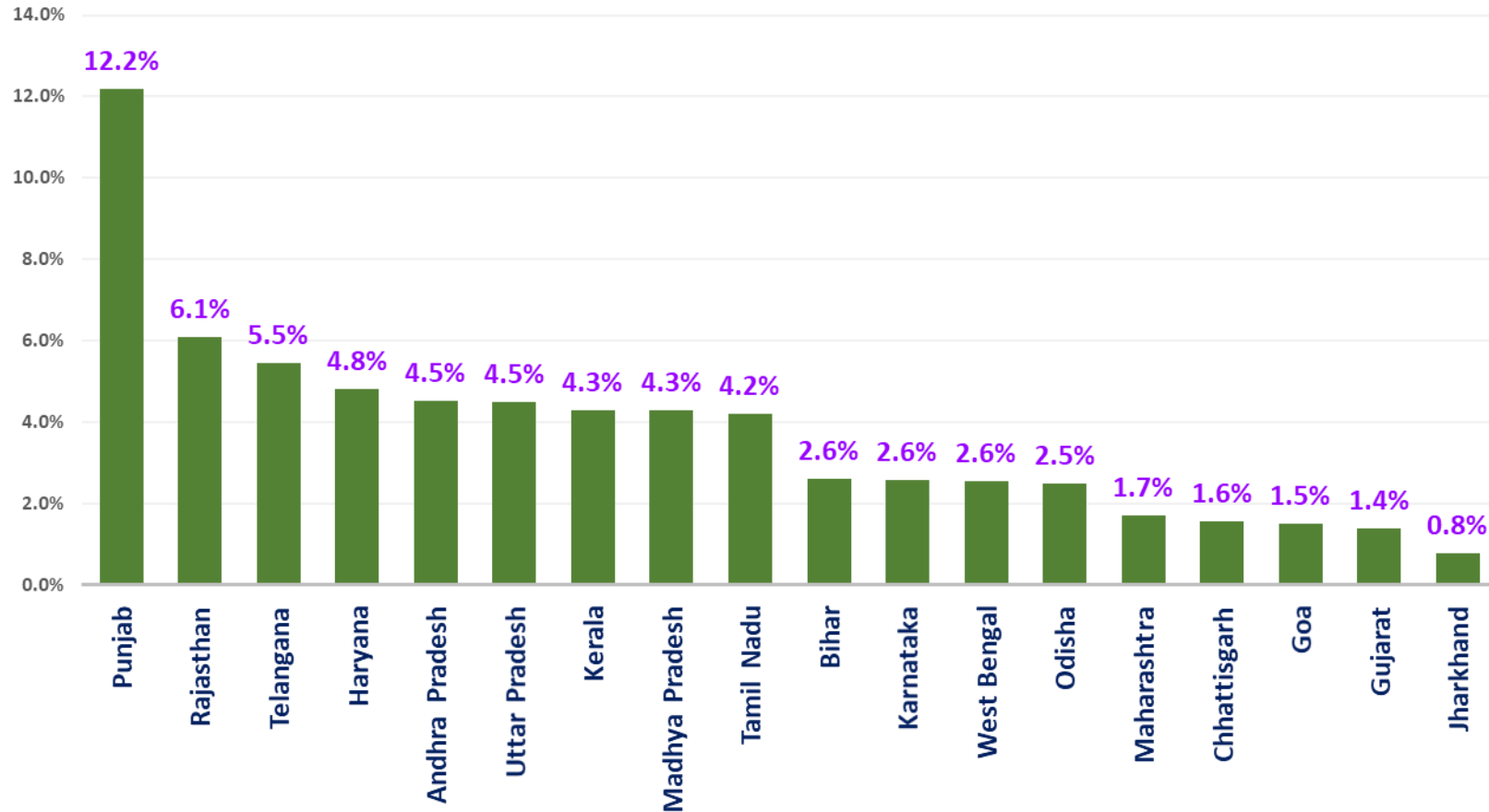
(2016-17 Actuals)



Revenue Surplus / Deficit as % of GSDP – 2016-17 (Actuals)



Fiscal Deficit as % of GSDP – 2016-17 (Actuals)



Note: The significant differences across the states is on account of UDAY scheme.

Major States' Outstanding Liabilities (As % of GSDP)

State	2016-17 Actual	2017-18 (BE)	2018-19 (BE)
Punjab	42.1	41.9	40.8
Rajasthan	34.0	36.7	37.6
West Bengal	34.1	36.7	36.9
Kerala	30.2	30.7	30.7
Uttar Pradesh	29.9	29.5	29.8
Andhra Pradesh	28.8	28.4	28.6
Bihar	19.6	26.3	26.7
Madhya Pradesh	25.4	27.3	26.3
Haryana	22.9	23.3	23.4
Telangana	19.5	20.6	21.4
Odisha	16.5	18.4	20.7
Karnataka	19.8	18.2	19.2
Goa	19.2	18.8	18.1
Chhattisgarh	16.6	18.2	18.1
Maharashtra	16.2	16.3	16.5
Gujarat	17.2	16.5	16.0

Table 6: Own Revenues of States

(Rs. in crores)

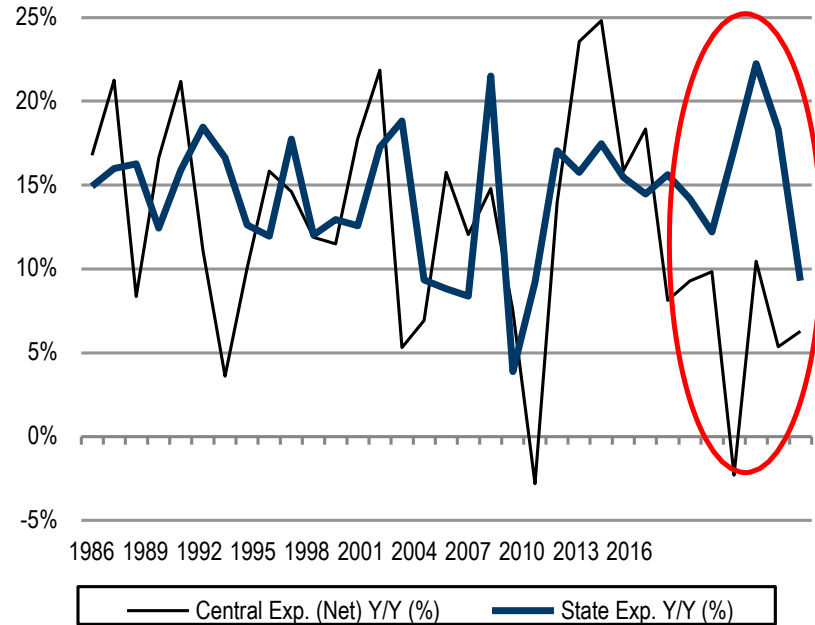
	2011-12	2012-13	2013-14	2014-15	2015-16 RE	2016-17 BE
Own Tax Revenue (OTR)	5,57,396	6,54,550	7,12,417	7,66,517	8,91,055	10,14,303
Own Non-Tax Revenue (ONTR)	99,128	1,17,262	1,32,543	1,40,926	1,63,523	1,94,926
Own Revenue Receipts (ORR)	6,56,523	7,71,811	8,44,960	9,07,443	10,54,578	12,09,230
OTR as % of GSDP	6.74	6.95	6.64	6.39	6.55	6.48
ONTR as % of GSDP	1.2	1.24	1.24	1.18	1.2	1.25
ORR as % of GSDP	7.94	8.19	7.88	7.57	7.76	7.73

Table 7: Composition of Own Tax Revenues of States

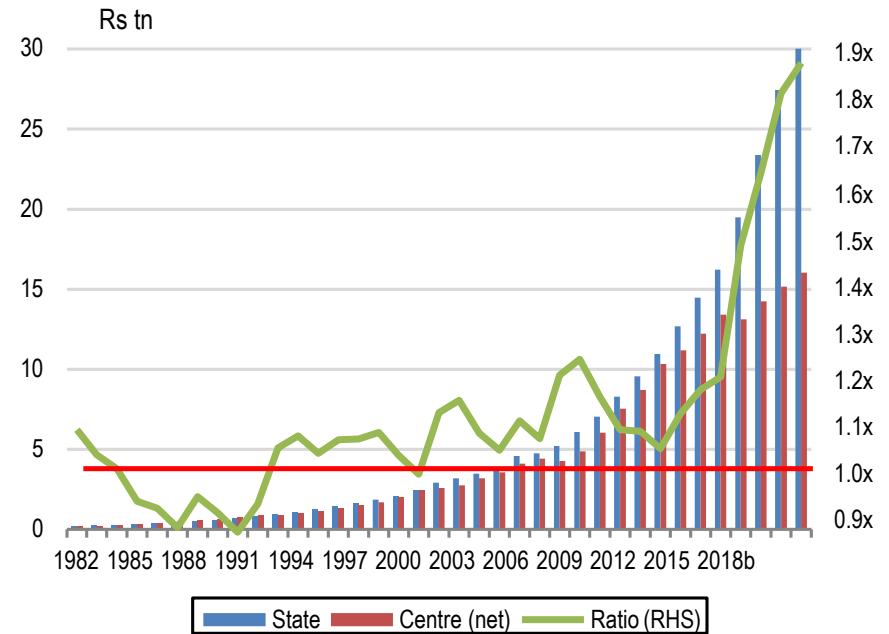
	(percent)					
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
					RE	BE
State Sales Tax/VAT	61.91	61.7	63.72	63.33	63.04	63.39
State Excise	12.88	12.62	11.42	11.7	12.05	11.77
Stamp & Registration Fees	11.55	11.55	10.85	10.96	10.86	10.73
Other State Taxes	13.67	14.13	14.01	14.01	14.06	14.11
Total	100	100	100	100	100	100
As % of GDP						
State Sales Tax/VAT	4.17	4.29	4.23	4.05	4.13	4.11
State Excise	0.87	0.88	0.76	0.75	0.79	0.76
Stamp & Registration Fees	0.78	0.8	0.72	0.7	0.71	0.7
Other State Taxes	0.92	0.98	0.93	0.9	0.92	0.91

States share of general government spending now 65%

State expenditure growing faster than Centre's



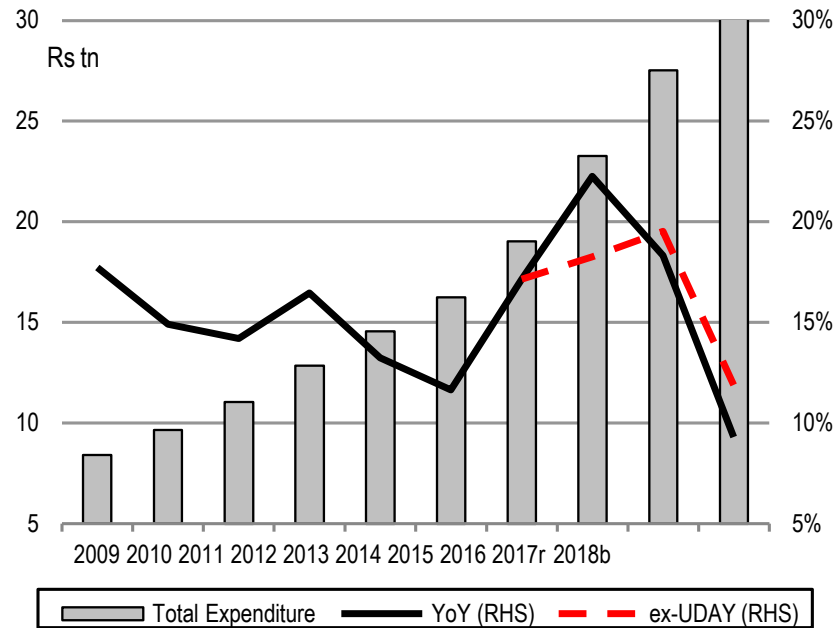
States now spend 1.87x the Centre's net spend



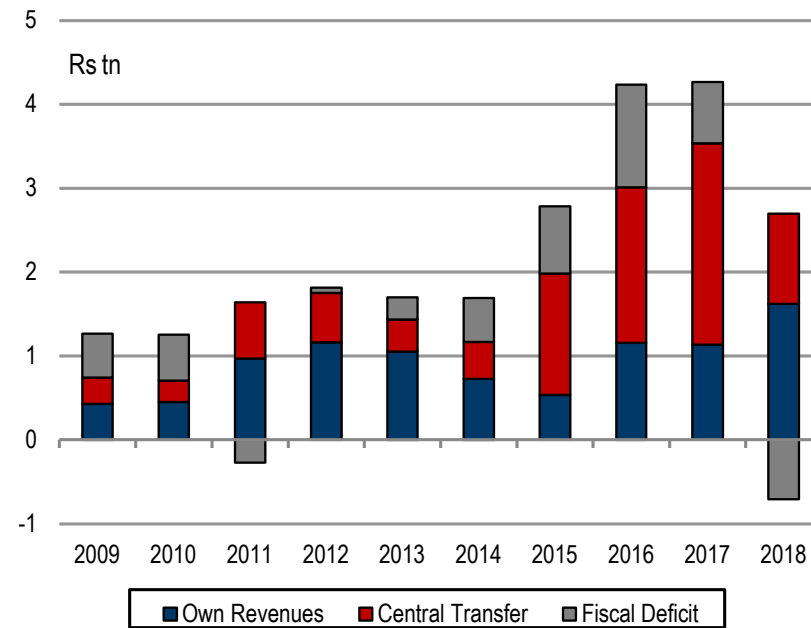
- Growth in aggregate expenditure of state governments has outpaced that of the central government for each of the last seven years
- From spending 6% more than the centre in FY2011, states are budgeted to spend 87% more than the Centre in FY2018b

Surge in transfers now over, growth slowing

Total state spend to grow 9% over FY17r



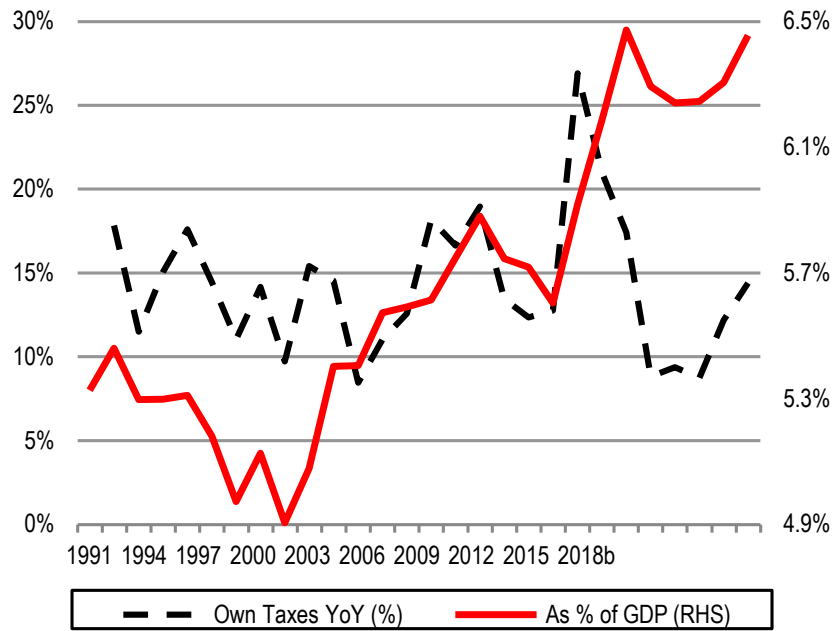
Sources of increase in expenditure



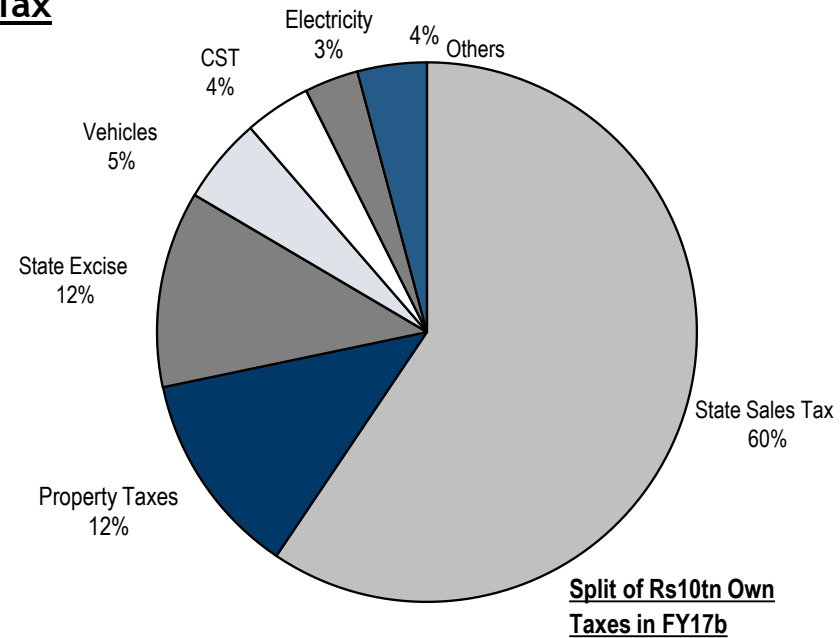
- Spending is budgeted to grow just 9.3% in FY2018
- Smaller increase in central transfers (due to slower tax growth at the centre, slower growth in grants) and a drop in the fiscal deficit
- Slowdown worse for states more dependent on central transfers

Own taxes continue to rise: 60% is VAT

States' own taxes have risen as % of GDP



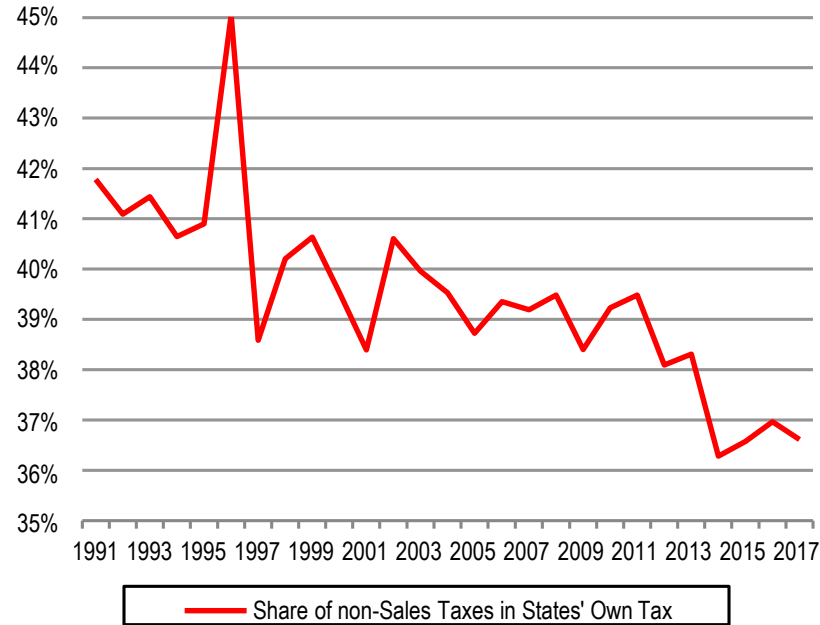
VAT is 60% of States' Own Tax



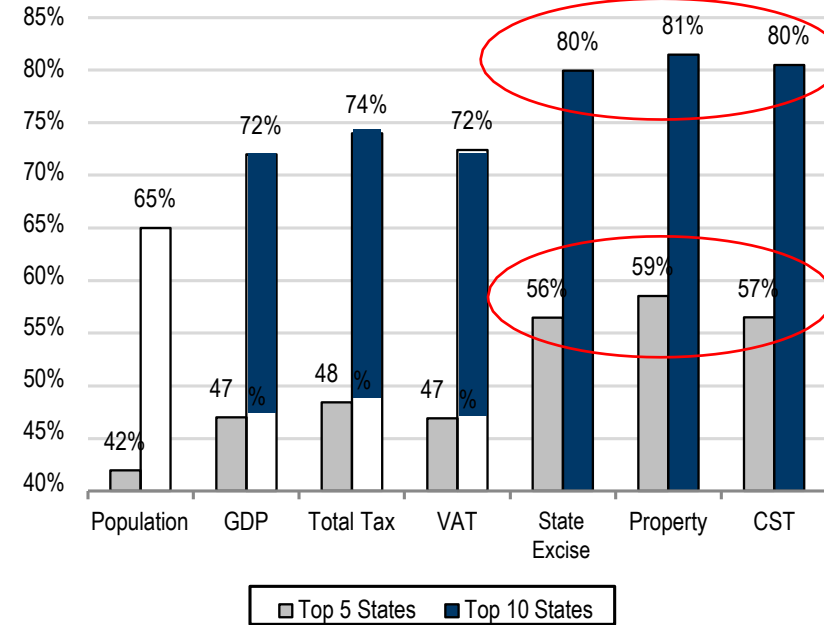
- A third of spending increase FY2011 to FY2018b came from own taxes
 - Own taxes as % of GDP up from 5.9% in FY2011 to 6.5% now; improvements in JH and TL
- VAT is 60% of own taxes; 40% of all VAT is from alcohol and petroleum products
- 40% of states' own taxes subsumed by GST

Share of Non-VAT taxes steadily declining

Share of non-VAT taxes steadily declining



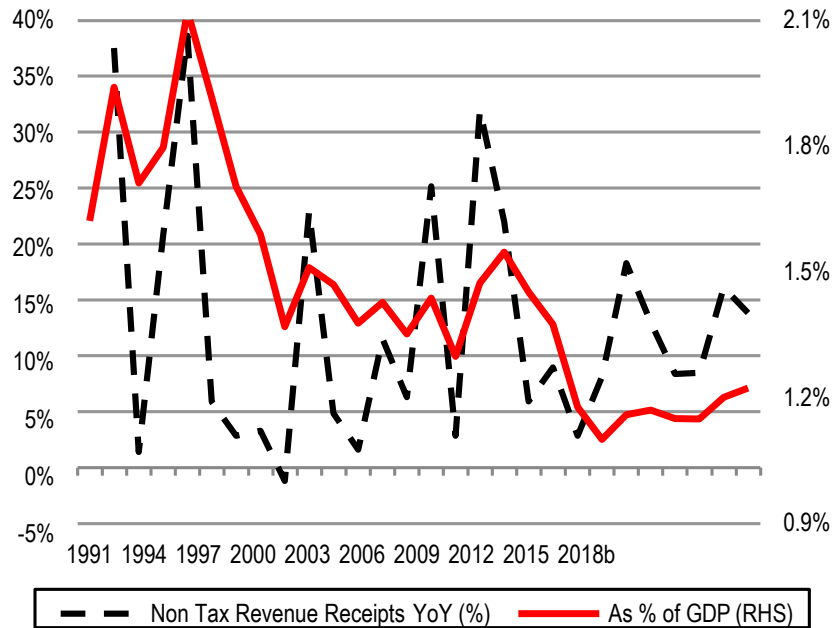
Non-VAT taxes are more concentrated



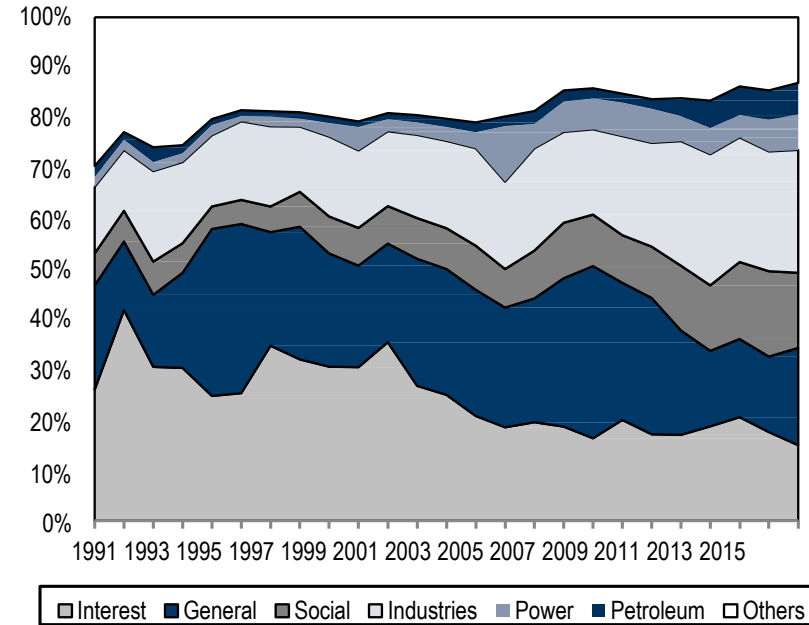
- Some non-VAT taxes are more cyclical (e.g. property), but decline has been steady
- Non-VAT taxes are also more concentrated than population/GDP/VAT
 - The top 5 for each of the non-VAT taxes are also different
- The perceived loss of freedom with GST may drive more innovation and hard work

Share of non-tax revenues also stagnating

Non-tax receipts have declined in importance



Share of non-tax receipts over time



- States' non-tax revenues fell from 18% of all revenue receipts in 1995 to 8% now.
 - From being 2.1% of GDP in 1995, they just add up to 1.2% of GDP in FY2018b
- Some of this trend is healthy: Interest income used to be a dominant source of non-tax income, but has come down significantly; industries, power and petroleum are up

Emerging issues in State Finances

- Additional debt burden to States on account of taking over of DISCOM liabilities under UDAY.
- The challenge of maintaining revenue surplus in the face of increasing interest payments, salary payments, pension payments, Farm Loan waiver schemes.
- Bunching of repayments.
- Rise in contingent liabilities.
- Growing deficits in power sector.
- Demand from employee unions for lifting of CPS

thank you...



Budget Processes

Budget Preparation

- Review meetings with line Dept.
- Scrutinising of Schemes
- Preparation of budget
- Authorization by Assembly

- Budget preparation is a top-down and bottom-up iterative process between the Department of Finance and the administrative / line Departments.

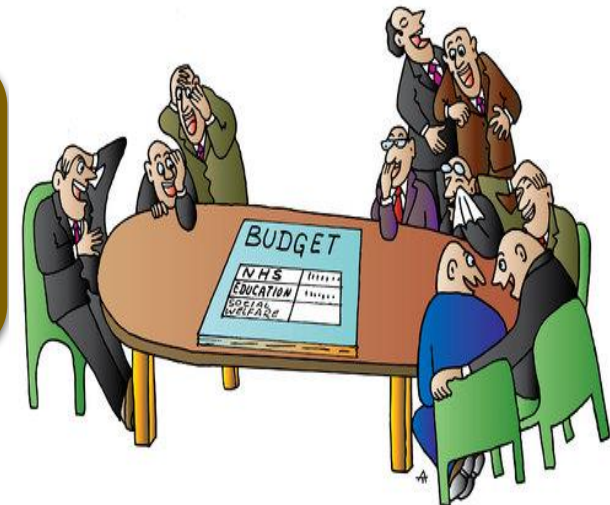
Feedback for next budget

Budget Monitoring

Ensuring management & control through internal & external audits

Budget Execution

- Distribution of funds
- Utilization by line Dept.



Accrual-based Budget

- Recognizes income and expenditure as they are earned.
- Takes into account future liabilities.
- Government liability extends to the life span of a policy.
- Provides information on the true cost of services.

Despite many advantages, there are implementation problems

- Accrual accounting is a pre-requisite.
- State administration at present is not attuned to accrual system.
- Proposal to introduce accrual budgeting in India in initial stages.

Traditional vs. modern budget making

- Traditional budget making: economy of inputs, financial regularity and procedural adherence
- New Public Management : greater flexibility on inputs and processes in return for greater emphasis and accountability in terms of outputs and performance
- NPM - the links between objectives, inputs, outputs and outcomes are made explicit
- Budgets have shifted from one year to extended time period known as medium term expenditure framework

MTEF and Performance budgeting

- Innovations in process – adversarial bidding for projects ; cooperative mechanisms of analysis, review and forward planning
- Innovations – public expenditure reviews, activity based costing
- Performance Budgeting – citizens can hold the Government accountable for performance
- Government performance information is incorporated into budgeting
- Focus to shift from control of inputs to outputs and outcomes in the interest of operational efficiency and results based accountability