PUBLIC FINANCIAL MANAGEMENT

PRESENTATION TO ALL INDIA AND CENTRAL SERVICES OFFICERS- JANUARY 22, 2022

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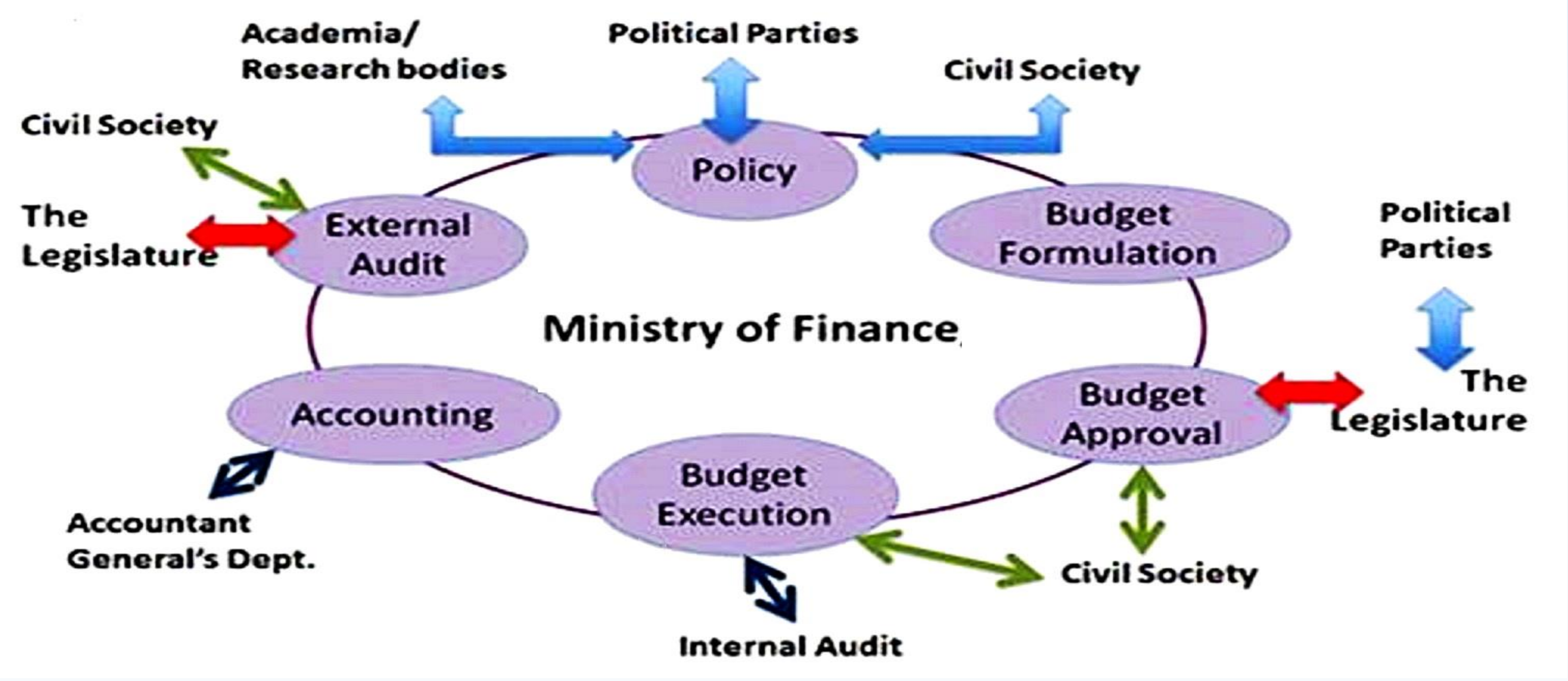
Scheme of Presentation

- What is PFM?
- Objectives of PFM
- PFM system in India
- Issues in PFM
- Reforms in PFM including public procurement
- Way Forward

What is Public Financial Management ?

- PFM refers to the set of laws, rules, systems and processes used by Central and State governments to mobilise revenue, allocate public funds, undertake public spending, account for funds and audit results.
- There are broadly six phases in PFM covering the entire budget cycle.



Objectives of PFM

- There are broadly four objectives
- Maintenance of fiscal sustainability and fiscal discipline.
- Ensuring allocative efficiency, i.e., allocation of limited resources as per the agreed priorities.
- Achieving operational efficiency. In other words achieving maximum value for money.
- Following due processes and ensure checks and balances in a transparent way to improve accountability.

Objectives of PFM

Why is PFM Important?

- Resources are not unlimited.
- Strong, transparent and accountable PFM system ensures effective use of resources resulting in growth and poverty reduction.
- Efficient PFM is a necessary, if not sufficient, condition for development outcomes.
- A strong PFM reduces, if not completely eliminates, corruption which is endemic in most developing nations.

PFM System in India

- Financial powers and functional responsibilities of the Union and the States are clearly demarcated in the Constitution: Union List, State List and Concurrent List.

- States assigned more functional responsibilities relative to their sources of revenue - vertical imbalance.

  - Taxes raised by the Centre 63%, Taxes raised by the States 37%.

  -Expenditure by the Centre 45% and expenditure by the States 55%

- Wide horizontal Imbalances.

  Per capita income of States varies from Rs.45,071 in Bihar to Rs.4,35,959 in Goa (2019-20). All-India Rs.1,34,186.

PFM System in India

- Therefore, the Constitution provides for transfer of resources from the Centre.
- Article 280. Constitution of Finance at the interval of every five years or earlier to recommend tax devolution to States and grants to those States which are in need of assistance under Article 275.
- Article 282: The Union or a State may make grant for any public purpose. This is a residuary power but used extensively to dispense grants through the erstwhile Planning Commission (not a Constitutional body) and through the Centrally sponsored schemes.

PFM in India (contd)

- Common financial procedures are mandated in the Indian Constitution.
- All moneys received through taxes, non-taxes, grants, repayments shall form Consolidated Fund of the Centre/State (Article 266).
- Parliament and State Legislatures to establish a Contingency Fund to meet unforeseen expenditure (Article 267).
- All the moneys for which the Government acts a custodian shall be parked into the Public Account (Article 266).
- For every financial year an Annual Financial Statement (commonly known as Budget) showing the estimates of revenue and expenditure shall be presented to the Parliament/State Legislature for its approval (Article 112).
- No money from the Consolidated Fund shall be appropriated and spent with out the sanction of the Parliament/State Legislature (Article 114).
- Provision for supplementary/ additional demands for grants and reappropriations (Article 115).

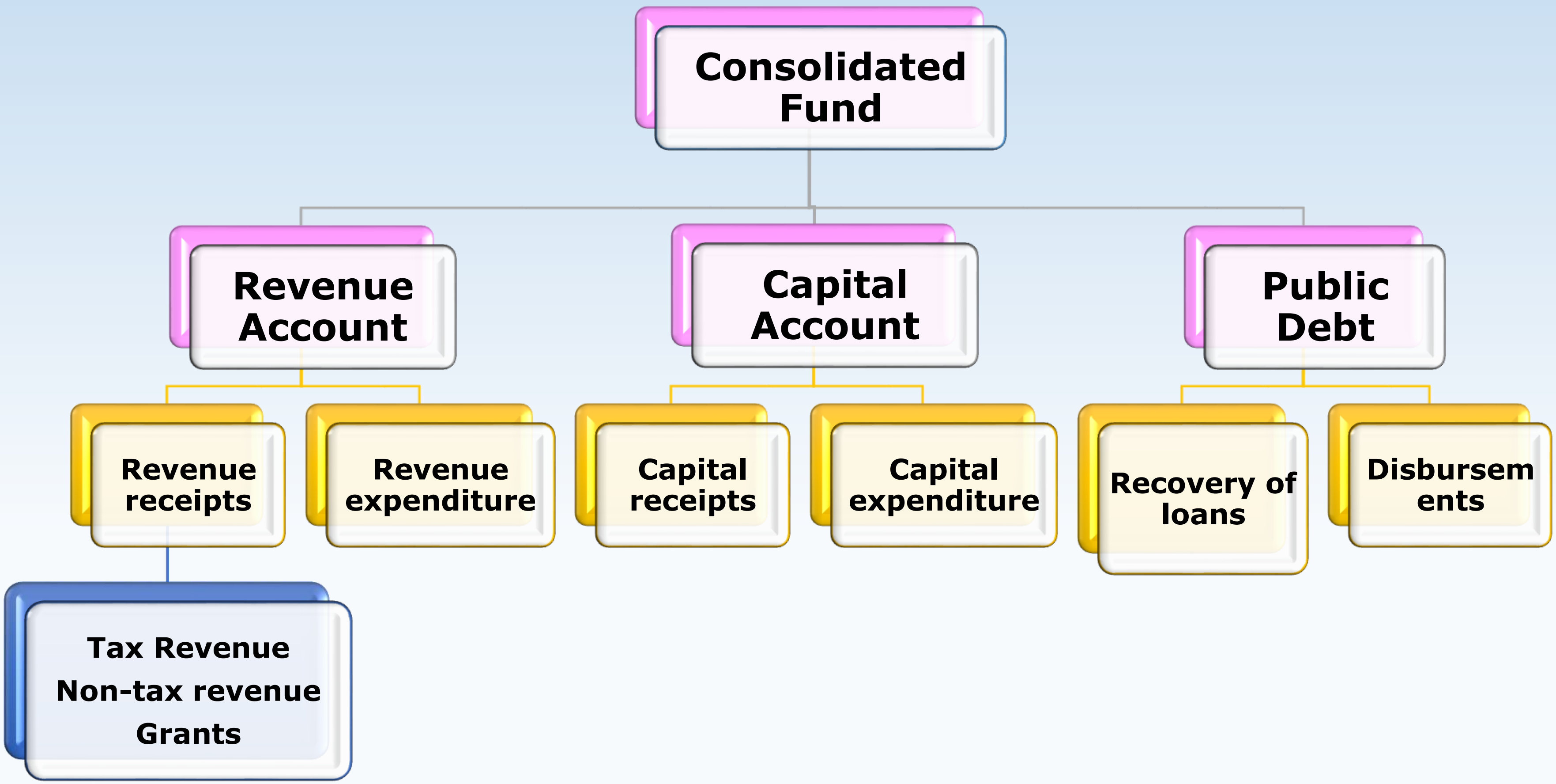
PFM in India (contd)

- Common accounting and reporting standards as prescribed by the C&AG, a Constitutional body(Article 148).
- Audit by C&AG on Appropriation Accounts for effective financial management to ensure financial integrity and accountability.
- The Reports of C&AG are examined by Public Accounts Committee, invariably chaired by a Member of the Opposition Party, for compliance.
- Controller General Accounts (not a Constitutional body prepares monthly and annual analysis of expenditure, revenues, borrowings and various fiscal indicators for the Union Government. The Annual Appropriation Accounts (Civil) and Union Finance Accounts are submitted to Parliament under Article 150 of the Constitution.

PFM in India (contd)

- General Financial Rules (GFR) prescribe rules and procedures to be followed by the government departments while managing the finances. Delegation of Financial Powers.
- Parliamentary oversight: Estimates Committee, Standing Committees, Public Accounts Committee.
- Central Vigilance Commissioner: Set up in 1964 to advise and guide Central Government agencies in the field of vigilance. Conceived to be the apex vigilance institution, free of control from any executive authority, monitoring all vigilance activity under the Central Government

Consolidated Fund



Broad Classification of Expenditure

Functions of the Government

General Services

a. Organs of State
b. Tax Collection
c. Other Fiscal services
d. Interest payments & Debt Servicing
e. Administrative services
f. Pensions and Mis. Gen. services

Social Services

a. Education, sports, art and culture
b. Medical & Public Health
c. Water supply sanitation, housing and urban development
d. Information and publicity
e. Welfare of SCs, STs, OBCs & Minorities
f. Labour and Employment
g. Social Security, Welfare & nutrition
h. Others

Economic Services

a. Agriculture and allied activities
b. Rural Development
c. Special Area Program
d. Irrigation and flood control
e. Energy
f. Industry and Minerals
g. Transport
h. Communications
i. Science and Technology
j. General economic Services

Grants-in-Aid

a. State Governments
b. UTs
c. Other Countries
d. Aid materials

Accounting Classification

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

Major Head	Sub Major Head	Minor Head	Group Sub Head	Sub Head	Detailed Head	Sub Detailed Head
Represents function	**Description of sub function**	**Indicates Program**	**Indicates Source of funding**	**Indicates specific scheme**	**Indicates various components of the schemes**	**Provides details about nature of expenditure**
(4700) Capital Outlay on Major Irrigation	(01) Major Irrigation Commercial	(154) Flood Flow Canal Project	(12) Centrally Sponsored Scheme	(26) Dam and Appurtenant Works	(010) Salaries	(011) Pay

PFM in India (concld)

- The system of Integrated Financial Adviser in each Ministry was introduced in 1975. The Financial Adviser is responsible to the Administrative Ministry as well as the Ministry of Finance. This facilitates the Ministry to exercise delegation of powers.
- Assisting the Ministry in achieving ‘value for money’ in an effective manner is the key role of FA.
- Responsible for budget formulation, outcome budget, expenditure and cash management, release of funds to States, programme formulation, appraisal and monitoring, screening of proposals, resource mobilisation, accounts and audit.
- Submits annual financial report and annual outcomes to the Ministry of Finance.

Delegation of Powers

- Delegation of Financial Powers Rules (DFPR), 1978 as amended from time to time.
- Delegation of powers is a tool of PFM
- General Rule: All financial powers vest with the Government.
- The Government is so vast that delegations is essential for managing public finances without delays.
- DFPR prescribe well defined powers to different functionaries.

- Rule 13(2): Powers can be delegated to an Administrator or Head of Department or any other subordinate authority except the following:-
  - Creation of posts
  - Write-of of losses
  - Reappropriation of funds exceeding 10% of original budget provision for either of the primary unit of appropriation or sub-head.
  - Department of the central govt. have full powers for incurring on light refreshment during conferences , meetings, foundation stone laying and other hospitality etc. subject to instructions issued by Ministry of Finance.

Delegation of Powers

Scheme/Project Appraisal		Scheme/Project Approval	
Cost (Rs. Cr.)	**Appraisal by**	**Cost (Rs. Cr.)**	**Approval by**
Up to 100	The Admn. Dept. in the normal course	Up to 100	Secretary of the Admn. Dept. in consultation with Financial Adviser
> 100 & up to 500	SFC Chaired by Secretary of the Admn. Dept.	>100 & up to 500	Minister-in-charge of the Administrative Department
> 500	EFC/PIB Chaired by Secretary (Expenditure), except departments/ projects/ schemes for which special dispensation has been notified by the Competent Authority	> 500 & up to 1000	Minister-in-charge of the Admn. Dept. and Finance Minister, except where special powers have been delegated by Ministry of Finance
		> 1000	Cabinet/ Cabinet Committee concerned with the subject, except where special thresholds have been laid down by the Cabinet/ Committee of the Cabinet

Issues in PFM

- Poor Fiscal marksmanship.
- Expenditure driven budgets.
- Delays in the implementation of projects resulting in time and cost overruns.
- Insufficient budget provisions for certain services, particularly for maintenance of assets already created.
- Bulk of the expenditure being committed, there is little scope for fiscal maneuverability. Large amounts of charged and committed expenditure (over 70%) restricts Parliament's/ State Legislatures' control.
- Supplementary demands for grants and reappropriations.
- Rush of expenditure in the last quarter.
- NIPFP study indicates close to 30% wastage in public expenditure.
- Lack of review and continuation of schemes which have outlived their utility.

Issues in PFM (Concld)

- In sufficient resource mobilization leading to dependence on borrowing making the public finances unsustainable.
- Automatic monetization of Central government treasury bills and conversion of overdrafts of states into loans till the late nineties. Centrally Sponsored Schemes, expansion of the Concurrent List.
- Poor identification of beneficiaries under welfare schemes/subsidies
- Far too many CSS, with each scheme comprising components and sub-components, resulting in spreading the resources too thinly and stretching the implementation capacity of States.
- Limited coverage of C&AG audit.
- Ineffectiveness of internal audit.

Reforms in PFM

- Search for improvements in budgetary outcomes resulted in the introduction of performance budget in 1968. There was no major impact as the measurement of performance was unsatisfactory.
- Termination of automatic monetization of ad hoc treasury bills in 1997.
- Introduction of the system of ways and means advances and overdrafts.
- Enactment of Fiscal Responsibility Legislation by the Centre in 2003 and by the States in 2005. Statutory limits on the levels of debt and on revenue and fiscal deficit levels. Adherence to fiscal rules by the Centre continues to remain poor.
- Move from annual budgeting to multi-year budgeting.
- Outcome budget was introduced in 2005-06 .This involves reporting expected outcomes or impacts of the government outlays on various programmes. Going beyond mere outputs, this covers the quality and effectiveness of goods and services. Yet to emerge as a robust fiscal tool.

Reforms in PFM (contd)

- Independent Cash and Debt Management Office in the Ministry of Finance.
- Government Accounting Standards Advisory Board (GASAB) entrusted to prepare a road map for switch over to accrual accounting.
- GASAB roadmap envisages a transition period of 10-12 years.
- Doubts regarding complexities involved while adopting accrual accounting. Capacity building holds the key.
- New FRBM Act to address the problem of creative accounting, contingent liabilities.
- Improving the estimates of revenue and expenditure.
- Greater adherence to medium-term fiscal framework. Though present FRBM mandates it, not adhered to in practice.

Reforms in PFM (concld)

- Public Financial Management System (PFMS) was initially started in 2008-09 as a pilot in four States of Madhya Pradesh, Bihar, Punjab and Mizoram for four Flagship schemes, i.e., MGNREGS, NRHM, SSA and PMGSY.
- Rolled out nation wide to provide a financial management platform for all plan schemes, a database of all recipient agencies, integration with core banking solution of banks handling plan funds, integration with State Treasuries and efficient and effective tracking of fund flow to the lowest level of implementation.
- DBT is a major reforms eliminating delays and leakages.
- Termination of on-lending States in 2005-06.
- Termination of the practice of direct transfers to implementing agencies bypassing State Governments (2015-16).
- Bringing CSS under 28 broad umbrella heads is at best a half-hearted measure.

Reforms in Public Procurement

- Introduction of e-procurement.
- Department of Expenditure, MoF Revised Guidelines
- Preparation of Preliminary Project Report and its presentation to the Administrative Ministry.
- Based on the feedback preparation of DPR
- Preparation of estimates
- Availability of land and obtaining statutory clearances.
- Pre-tender activities to include a) preparation of architectural and other designs, b) in case of complex projects organise a pre-tender inviting conference, c) empanelment of contractors, d)preparation of tender documents containing details conditions specific to project, payment terms, quality assurances, technical and financial criteria for bidders and dispute and arbitration mechanisms.

Reforms in Public Procurement

- Open on-line tendering.
- Rejection of a single bid not to be done in a routine manner as it involves cost and time overruns.
- GFR 2017 provides for four methods for engaging consultants, 1) Quality and Cost-Based Selection (QCBS) when the emphasis is on selecting the most competent consultant, 2) Least Cost System (LCS) with quality still being a consideration 3) Single Source Selection (SSS) for proprietary equipment and services, and 4) Fixed Budget Selection (FBS) to be used where the type of consultancy service is simple and standardised.

Swiss Challenge – A New Method of Procurement

- A Swiss Challenge is a method of bidding, often used in public projects, in which an interested party initiates a proposal for a contract or the bid for a project.
- The government then puts the details of the project out in the public and invites proposals from others interested in executing it. On the receipt of these bids, the original contractor gets an opportunity to match the best bid.
- But on the flip side, by allowing a bidder to initiate an idea and giving him the first right of refusal, the Swiss Challenge can promote favouritism.
- To guard against this, legal experts suggest an open list of public projects that allow Swiss Challenge and full public disclosure of bid details when the government receives a proposal.
- The Swiss know how to get more bang for the buck.

Way Forward

Revenue Reforms

- A beginning has been made to reform the indirect tax system in the country with the introduction of GST in July 2017.
- The system of taxation in India remained regressive as the collection of indirect taxes exceeded direct taxes. For the first time, direct tax revenue exceeded indirect tax revenue in 2007-08. Thanks to computerisation. Formalisation of the economy may improve direct tax collections further.

Expenditure Reforms

- Expenditure Reforms Commission has made a number of recommendations but they are yet to be acted upon. They submitted as many as 10 reports covering various Central Ministries.
- There are no sunset period for government schemes.
- The CSS which are supposed to be reviewed every five years and made coterminous with the Finance Commission award period is yet to see the light of the day.

Way Forward

- The sanctioned strength which was fixed years ago is still sacrosanct.
- A Rupee saved is a Rupee earned.
- Inclusion and exclusion errors in the selection of welfare programmes.
- Leakages in the public distribution system.
- A major review of subsidies which do not serve the poor is an imperative.

Adherence to Fiscal Rules

- Lack of adherence to fiscal rules. Too many escape clauses. Creating accounting and off-budget borrowings and deferment of expenditure commitments are few such instances.
- The fiscal defined in the revised FRBM Act 2018 as the balance of operations in the Consolidated Fund falls short of the debt ceiling that includes public sector and off-budget borrowings.
- There is an absence of a Fiscal Council to assess and evaluate the fiscal plan as well as performance and forecasts made by the governments.

Way Forward

- The medium term policy statements like Medium Term Fiscal Policy (MTFP) and Medium Term Expenditure Framework (MTEF) are not adhered to.
- Even the outcome budgets have become routine and are not reviewed at periodic intervals by the Administrative Department.
- There are no penalty clauses for not adhering to the FRBM targets. Just name and shame.

Other Reforms

- A time bound plan for phased adoption of standard-based accounting and financial reporting and eventual adoption of accrual based accounting.
- Strict adherence to observations made by C&AG.

thank you…