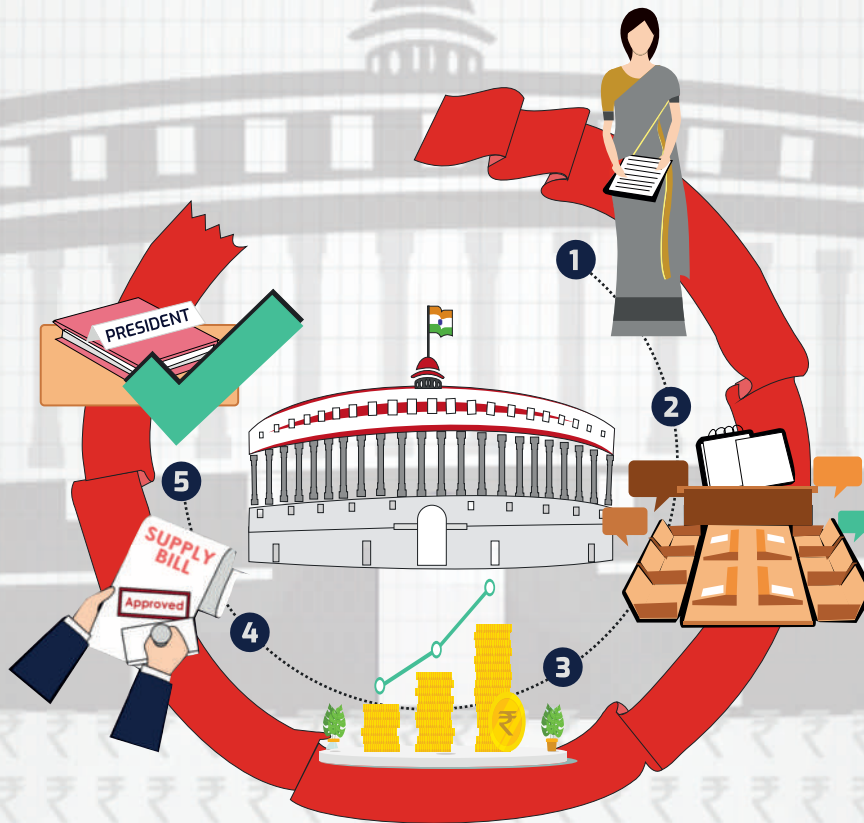


GOVERNMENT BUDGETING

WHAT, WHY AND HOW?



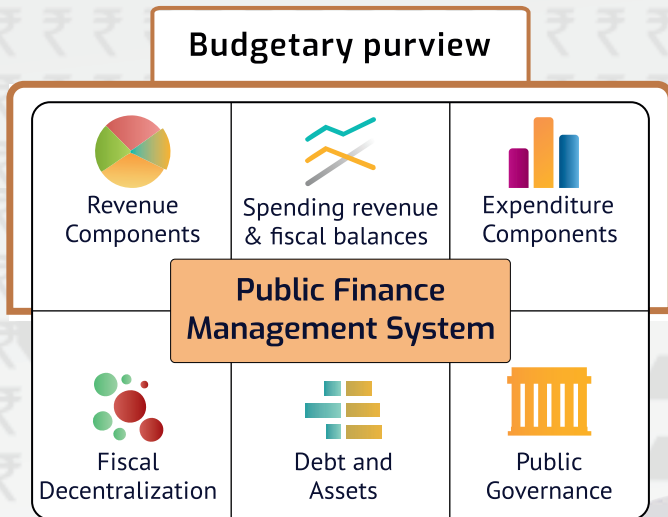
INTRODUCTION

In the wake of the coronavirus pandemic, both the Union and State governments are looking forward to making use of the Budget as an instrument to achieve fiscal prudence. However, unlike earlier years, the 'economics of the government' is no longer exclusively revealed on Union budget day, where the finance minister would announce new economic policies and schemes. In the present times, significant economic policy announcements take place throughout the year, outside the purview of the budget speech day.

With this trend, "budget credibility" becomes an important issue. The gap between what is promised in the budget and the budgetary allocations to back up the announcements has not yet been technically analysed consistently. Besides large deficits and debt, there are questions of comprehensiveness, transparency and accountability in the Budgets. The practice of repeated postponement of targets, timely non-settlement of bill payments and off Budget financing to show lower deficits has been common.

In crux, budget announcements of successive governments have been less about fiscal arithmetic and more about the political vision of that government. In this context, it becomes essential to analyse the present budgetary process in a parliamentary democracy like India, how it has evolved over the period of time, what are the weaknesses that are persisting in the budgeting process and how our budgeting system can be reformed so as to meet the growing demands of the nation to achieve sustainable growth and better human development outcomes.

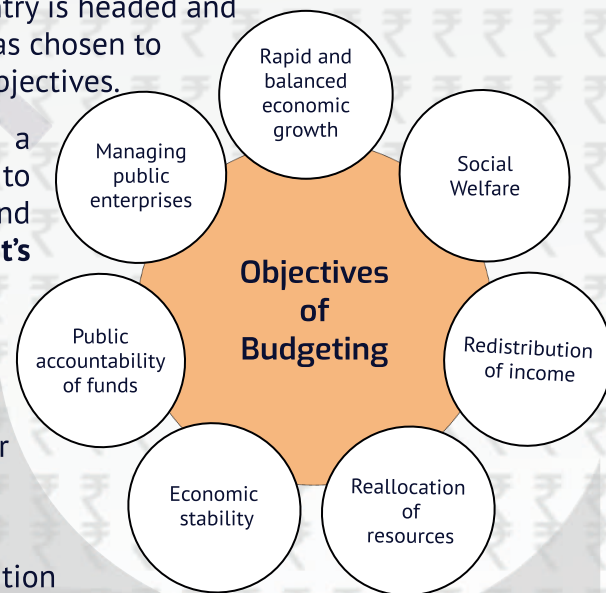
What is **the meaning of budgeting** and what are its objectives?



Budget or the annual financial statement is a statement of estimated receipts and expenditures of the government in respect of every financial year. Budgeting is the process of **estimating the availability of financial resources** and then **allocating them to various activities of the government** according to a predetermined priority. It is an attempt to balance scarce means with public needs and ends and thus plays a crucial role in the **Public Financial Management System**.

- Budgets go beyond money; they **represent choices, policies and philosophies** and indicate the direction in which a country is headed and the path it has chosen to achieve its objectives.

- The central purpose of publicly disclosing the Budget in a democracy and seeking approval from the legislature is to make the policy-making and governance transparent and participatory. A budget is thus a **manifestation of government's Fiscal Policy**.

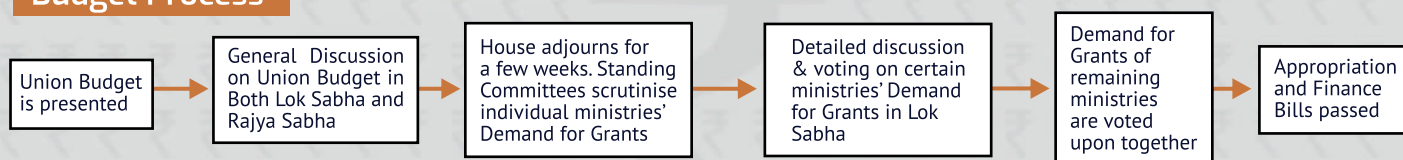


Budgetary Process in India

Normally, the budget-making process starts in the third quarter of the financial year and the procedure involves four different operations that are:

- **Preparation of the budget:** Article 112 of the Indian constitution refers to budget as the 'Annual Financial Statement'. It is made through a consultative process involving ministry of finance, NITI Aayog and spending ministries. Finance ministry issues guidelines for spending, based on which ministries present their demands and the Budget Division of the Department of Economic Affairs in the finance ministry is the nodal body responsible for producing the Budget. Major components of the budget are-
 - Estimates of the **money the government expects to spend** on various ministries and of the money that will be raised from different sources such as levy of taxes and dividends from public enterprises.
 - An estimate of the **borrowing requirements** of the government and its overall debt.
 - An account of **money raised or spent by the government in the previous year**, in comparison to the estimates it had given to Parliament.
- **Enactment of the budget:** Once the budget is prepared, it goes to the parliament for enactment and legislation. The budget has to pass through the various stages during this process.

Budget Process



- **Execution of the budget:** Once the finance and appropriation bill is passed, the executive department collects the revenue and starts spending money on approved schemes.
 - Various ministries are authorized to draw the necessary amounts and spend them.
 - For this purpose, the Secretary of ministers acts as the chief accounting authority and the accounts of the various ministers are prepared as per the laid down procedures.
- **Audit of the budget:** This involves the Parliamentary Oversight of the budget which is necessary to make sure that amount sanctioned by Parliament is being used in an appropriate manner. Financial Committees scrutinise and exercise parliamentary control over government expenditure and table reports in Parliament.
 - **Estimates Committee:** The Estimates Committee facilitates Parliament's control over the expenditure sanctioned and incurred, and over the general policies of the administration. The Committee's main tasks are to:
 - ▶ report on the improvements and administrative reforms that can be made,
 - ▶ suggest alternative policies in order to bring about efficiency in administration, and
 - ▶ suggest whether the proposed expenditure is within the limits of government policy.
 - **Departmentally Related Standing Committees (DRSCs):** DRSCs examine the proposed estimates of expenditure by various ministries.
 - ▶ Before 1993, this function was performed by the estimates committee.
 - **CAG and PAC:** After the financial year ends, the accounts prepared by various ministries are audited by the Comptroller and Auditor General of India (CAG), the reports of which are further examined by the Public Accounts Committee (PAC).
 - ▶ The government responds to every report of the PAC by stating the recommendations that have been accepted or rejected by them. Based on these responses, the PAC prepares Action Taken Reports and tables them in Parliament.

How has India's Budgetary process evolved?

The process of budgeting has evolved over the past six decades to reflect the strength of India's democratic processes in shaping its economy. This can be seen through various developments that have taken place and various measures taken over a period of time:

- **Change in approach from outlays to output to outcome budgeting:** Traditionally, the budget was viewed merely as a statement of receipt and expenditure in terms of financial outlays. Since 1968, India's ministries started bringing out a **Performance Budget** trying to link financial aspects to physical results, extending budget management to output. Later, **Outcome Budget** was introduced in India in 2005-06, under which expected results were measured not only in terms of monetary units or physical infrastructure but also in terms of qualitative targets and achievements.
 - For example, financial allocations under primary education are outlays, construction of an x number of primary school buildings could be the desired output, the outcomes could be to educate an x number of children up to the primary level.



- **Introducing Zero-Based Budgeting (ZBB):** ZBB refers to planning and preparing the Budget from scratch or 'zero base' unlike a traditional Budget that is based on incremental increases over the previous year. It involves review and justification of each ministry's expenditure in order to receive funding at the beginning of each financial year.
 - In India, the ZBB was adopted by the department of science and technology in 1983 and in 1986, the government made it compulsory for all ministries to review their activities and programmes and prepare their expenditure estimations based on the concept of ZBB.
- **Inclusion of gender budgeting:** Gender budgeting is a strategy for ensuring gender sensitive resource allocation and a tool for engendering macro-economic policy. It does not involve creating a separate budget for women.
 - In 2007, the **scheme on Gender Budgeting** with a view to building capacity and encouraging research was introduced.
 - Every year, a few months before the preparation of the annual budget, the Ministry of Finance issues a **Gender Budget Statement (GBS)** that seeks ministries and departments to highlight the quantum of public expenditure they have earmarked for women for the upcoming year.
 - Currently, **Gender Budgeting Cell (GBCs)** have been constituted to serve as focal points for coordinating gender budgeting initiatives within their Ministries and across Departments.
- **A move towards participatory budgeting:** Participatory budgeting, allows people to deliberate and negotiate over the distribution of public resources and empowers them to better understand their rights and duties as citizens as well as the responsibilities of the government.
 - Kerala was the first Indian state to experiment with participatory budgeting in 1996. Recently, the central government launched an online portal on the MyGov.in platform to invite ideas/suggestions from the general public for the Annual Budget 2021-22.
- **Adoption of fiscal rules:** Following economic liberalisation in 1991, when the fiscal deficit and debt situation seemed to head towards unsustainable levels, the government commenced on a path of economic liberalisation and thereby fiscal rules were adopted in the form of **Fiscal Responsibility and Budget Management Act (FRBM Act) in 2003**.
 - Achieving revenue and expenditure targets became more important under fiscal rules which changed the open-ended nature of the budget with defined path for fiscal targets like fiscal deficit and debt burden.

Budgetary Deficits and their implications

- **Fiscal Deficit:** It is the gap between the government's expenditure requirements and its receipts. It indicates the total borrowing requirements of the government from all sources and is a **key variable in judging the financial health of the public sector** and the stability of the economy.

- **Fiscal Deficit = Total expenditure – (Revenue receipts + Non-debt creating capital receipts).**

- **Revenue Deficit:** It refers to the excess of government's revenue expenditure over revenue receipts. When the government incurs a revenue deficit, **it implies that the government is dissaving** and is using up the savings of the other sectors of the economy to finance a part of its consumption expenditure.

- **Revenue Deficit = Revenue expenditure – Revenue receipts.**

- **Primary Deficit:** Primary deficit equals fiscal deficit minus interest payments. This **indicates the gap between the government's expenditure requirements and its receipts**, not taking into account the expenditure incurred on interest payments on loans taken during the previous years.

- **Primary deficit = Fiscal deficit – Interest payments.**

- **Abolition of five-year development planning process along with the Planning Commission:** The abolition of Planning Commission in 2014 was based on the objective of improving country's economic development in a more globally integrated environment with higher participation of private sector.

- The distinction between plan and non-plan expenditures was removed from 2017-18 as it usually led to expanding the plans beyond the resource limits and resulted in neglect of maintenance of existing assets both at national and sub-national levels.
- ☉ **Merging of Railway and General Budget:** Separate railway budget was introduced in 1921 on the recommendation of Acworth Committee report as railway revenue formed a major part of country's GDP. However, over the years, the size of the rail budget diminished and it became a tool for populism leading to inefficiency. In 2016, the NITI Aayog committee headed by Bibek Debroy recommended the merger after which the practice came to an end.
- ☉ **Budget Advancement:** The Budget is now presented 27 days before the earlier practice of presenting the budget on last day of February. The objective behind this move is to conclude the Budgetary process before the financial year begins on April 1.
- ☉ **Rationalization of Centrally Sponsored Schemes (CSS) and expenditure thereon:** Budget 2016-17 on the recommendations of a sub-committee of Chief Ministers formed by NITI Aayog, introduced a new classification system for the Centre's spending, based on the categorization of CSS. It pruned the existing 66 CSSs to 28, and then further divided them into three categories—six 'core of the core' schemes (highest priority with 75:25 expenditure formula), 20 core schemes (second priority with 60:40 expenditure formula), and two optional schemes (50:50 expenditure formula).

What are the **weaknesses persisting** in the Indian Budgetary Process?

The Second Administrative Reforms Commission in its 14th report titled 'Strengthening Financial Management Systems (2009)' had identified certain major weaknesses in the current budgetary system and implementation process due to which questions are being raised about the credibility of Budget. This has also led to reduced public interest in the yearly budgets announced by the government. Certain chronic issues that exist are:

- ☉ **Issues with Outcome Budgeting(OB):** The outcome budget is yet to emerge as a robust fiscal instrument to influence the decisions over public finances and provide a framework to judge the performance of the government. Major issues are:
 - **Incompatible administrative structure:** Much of the development interventions in India are routed through the state governments. But key line departments in most states are yet to adopt planning and service delivery processes which are oriented around outcomes.
 - **Lack of debate:** Outcome budgets are separately placed by the departments later in the Budget session and do not receive the needed debate, scrutiny and visibility in the public arena.
 - **Underdeveloped Components:** The building blocks of the outcome budget – measurement of performance indicators, specification of standards, costing of programmes, and a monitoring and evaluation system – are still evolving in India.
 - **Lack of Knowledge:** Limited knowledge and understanding about the linkage between specific Government interventions and the intended outcomes, makes the whole exercise of OB futile in the long run.
- ☉ **Hindrances in implementing Gender Budgeting:** Over the last 15 years, the size of gender budget has remained below 5%, mainly due to reasons such as:
 - **Lack of sex-disaggregated data:** particularly in access to resources, opportunities and security.



- ❑ **Limited gender budgeting initiatives due to limited analysis:** Absence of adequate evidence correlating current budgetary changes and intended outcome has kept many initiatives in limbo as most of the gender budgeting initiatives worldwide are still at the stage of analysis.
- ❑ **Resource and capacity constraints:** Gender budgeting requires political will, adequate resources and capacity to support a process of transformation of the traditional budget-making processes.
- 🟡 **Issues in main streaming participatory budgeting:**
 - ❑ **Lack of education and awareness** among the people especially about various concepts of budget and key terminology is hampering their effective participation.
 - ❑ **Infrastructural difficulties** like digital divide may seclude some regions and sections of the society from participating.
 - ❑ **Public institutions lack capacity and resources** to engage citizens.
 - ❑ **Diversity of opinions & unnecessary delays** in budgetary process.
- 🟡 **Changing course of Deficit Management:** Due to setbacks faced by the economy after the Global Financial Crisis and a domestic slowdown since 2008, there have been several amendments to the FRBM Act essentially postponing the fiscal targets. Subsequently government stopped targeting revenue deficit and instead focussed only on fiscal deficit.
 - ❑ With no compulsion to reduce revenue deficit, the government has, been containing the fiscal deficit by reducing its capital expenditure. Thus, FRBM Act is achieving the opposite of what it was supposed to do i.e., minimize the revenue deficit.
- 🟡 **Doubtful credibility of the budget:** Large deviations from revenue and expenditure targets may have important implications for macroeconomic stability, public service delivery, and social welfare. India's budget credibility has been questioned several times in the past.
 - ❑ For instance, a study conducted by civil society group **Campaign for Adivasi and Dalit Rights to Education (CADRE)** has highlighted that government scholarships specifically designed to benefit the **Dalit and Adivasi communities in India were being denied** to eligible beneficiaries as the **budgetary allocations amounting to \$800 million failed to reach the implementing authorities** in just one year alone.

Budget Credibility

- 🟡 Budget credibility describes the **ability of governments to accurately and consistently meet their expenditure and revenue targets**. It is about upholding government commitments and showcases government's Fiscal markmanship.
 - ❑ For instance, the July 2019 Budget expected nominal GDP to grow by 12% in 2019-20 (the highest level since the 13% growth witnessed in FY14) but the First Advance Estimates expect the nominal GDP to grow by just 7.5% (which is a 42-year low). This reflects poor fiscal markmanship.
- 🟡 Sometimes, deviations from the budget are unavoidable and can be a result of external economic shocks, or even indicative of smart managerial decisions to address unanticipated events.
- 🟡 Still, **when budgets are not implemented as planned**, spending priorities can shift, deficits may exceed projections and that **has real human costs** as it may:
 - ❑ compromise delivery of critical services.
 - ❑ erode public trust in the government.
 - ❑ threaten progress toward achieving the SDGs. (SDG indicator 16.6.1, assesses whether governments implement their budgets).
- 🟡 **Institutional gaps**
 - ❑ The **transition from Planning Commission to NITI Aayog** has created an apprehension that the role played by Planning Commission over tackling of regional inequities will not be adequately fulfilled by NITI Aayog.
 - ❑ Also, the control of central government on revenue from indirect taxes has been diluted substantially after the formation of **GST council**, thereby creating uncertainty about the revenue mobilisation by the centre in the upcoming financial year.

- **Parliamentary incompetencies:** Present standing committee system lacks the necessary technical and other competencies that are required to scrutinise the demand for grants by the Ministries due to which **most of the demands are guillotined**, i.e., put to vote without any discussion.
- **Lack of Transparency and Accountability:** The Indian budget is considered less transparent as it puts only limited information in the public domain. An example could be government's frequent resorting to **Off-Budget borrowings** to finance its expenditure and to artificially manage fiscal deficit targets. Such borrowings are not the part of Consolidated Fund of India (CFI) and are not shown in the budget, **thus remain beyond the control of Parliament**.
 - Off-budgetary or Extra budgetary resources **are loans that are taken not by the Centre directly, but by public sector undertakings** on the directions of the central government.
- **Inadequate allocations in critical sectors:**
 - As per government's data, the budgetary share for **education** sector is witnessing a downfall for the last five years and has **remained at 3-4% of GDP** much less than the requirement of at least 6%. Which has seen a further decrement of 6.1% of in the Budget of 2020-21.
 - Similarly, India's public **health** expenditure (sum of central and state spending) has **remained between 1.2% to 1.6% of GDP** between 2008-09 and 2019-20 which is highly inadequate. Although, Budget 2021-22 has seen an almost 137% increment in its allocation.
 - India's **defence** budget had also been decreasing in the past decade and is nearly 2% of GDP against the Standing Committee recommendation of 3% necessary to ensure adequate preparedness of the armed forces.
- **Other issues:**
 - **Inaccurate Budget estimates:** Frequent resorting to supplementary grants in addition to the main budget, incorrectly classifying revenue expenditure as capital expenditure and vice-versa, results in an overestimation of capital expenditure.
 - **Delay in implementation of projects:** Data for last six years on implementation of central sector infrastructure projects that were announced in the budget shows that project completion has always been tard with time and cost overruns becoming routine features.
 - **Skewed pattern of expenditure:** Spending remains skewed towards revenue expenditure instead of capital expenditure.
 - **Ad hoc project announcements:** Too many policy changes through frequent press releases are often not in line with the publicly affirmed economic ideology and sometimes appear contradictory or unreasonable.
 - **Lack of focus on prevalent issues such as** budgetary financing of Climate change mitigation and adaptation measures.

What reforms are needed in our budgeting system to address the aforementioned weaknesses?

- **Dealing With issues of Budget Credibility:** Uncertainty regarding the budget can be reduced through sound macroeconomic forecasts and steps such as-
 - **Medium Term Expenditure Framework (MTEF):** Linking policy making to budget through MTEF can improve budget realism, since it-
 - ▶ **Enhances accountability in program execution:** by ensuring forward planning regarding availability of fund to various programs in a medium term.
 - ▶ **Reduces the tendency of ambitious annual spending plans** based on blown up revenue projections.
 - ▶ **Emphasises on sectoral priorities,** based on government objectives and policies rather than on annual increments.

- ▶ **Reduces the fiscal strain** coming from politically induced resource trade-off.
- ▶ The **Government of India adopted MTEF in 2012** which was further strengthened in 2016. However, the projection of expenditure categories made by the MTEF does not adequately reflect in the Budget. Primary reason for this is that the MTEF statement does not bind the Budget on its recommendations and thus only plays a peripheral role in it.

❑ **Establishing a Fiscal Council:** The **13th and 14th Finance Commissions** advocated for establishing independent fiscal agencies to review the government's adherence to fiscal rules, and to provide independent assessments of budget proposals.

- 🕒 **Enhancing budget transparency and strengthening accountability:** Budget transparency and accountability can be improved through steps like establishing a well-designed budget classification, ensuring comprehensiveness of the information provided in the budget documents, increasing transparency in transfer of resources between the tiers of the government and publishing a **Pre-Budget Statement**, which can be scrutinised by the legislators and the public at large before the annual budget is presented.
- 🕒 **Rectifying flaws in the Gender Budget Statement (GBS):** The estimates of budgetary allocations for women and girls should be based on a roadmap prepared by each ministry/department, which shows how they plan to meet gender needs and bridge existing gender gaps. This will convert the GBS from being a casually-reported ex-post statement to a document that is used on a continuous basis to transform the lives of women and girls in each department's domain of work, by enabling government services to reach them.



COVID-19 and its impact on Government Budgeting

- 🕒 **Reduction in the Fiscal Space:** The COVID pandemic and the subsequent lockdowns brought all economic activity to a halt leading to sharp decline in government income and an increase in expenditure as the governments look to combat the virus. This has led to significant widening of the fiscal deficit in Q1 of FY 2021.
 - ❑ Central government revenue declined by 47 per cent and Total expenditure has seen a 13 per cent spike led by an increase in capital expenditure. With this, the fiscal deficit at Rs 6.62 lakh crore, has seen a 53 per cent increase.
- 🕒 **Change in Sectoral Priorities of the Government:** There has been a notable increase in revenue expenditure in rural development, agriculture and welfare schemes which could be attributed to the government's pandemic relief programmes.
- 🕒 **Impact on State Finances:** States were at the forefront of the fight against the pandemic. As a result, their finances have taken a body blow in the first half of 2020-21.
 - ❑ In 2020-21, about half the states have budgeted the GFD-to-GSDP (gross state domestic product) ratio at or above the 3% threshold and have witnessed '**scissor effects**' – loss of revenues due to demand slowdown, coupled with higher expenditure associated with the pandemic.
 - ❑ A report by RBI has highlighted that Pandemic-related spending, particularly on health and other support measures, are likely to keep these expenditures high, prolonging the 'scissor effects'. In addition, states' fiscal position is likely to be affected by a surge in contingent liabilities.
- 🕒 **Independent Parliamentary Budget Research Office (PBRO):** The PBRO as an independent organisation can build a mechanism so as to take into account the views and opinions of the citizens and civil society organisations, including the media, on the Budget. This will help reduce the gap between the policies of the government and the aspirations of the people leading to effective budgetary governance.

- **Climate-responsive budgeting:** It involves a range of tools and approaches, such as climate tagging of budget lines, environmental cost-benefit analysis, carbon pricing, etc. along with legislative review of public expenditure contributions towards national climate goals, assessing tax revenue effects of climate-oriented policies, and induced economic transition on the fiscal sustainability.

CONCLUSION

The Budget in India remains central to the overall fiscal management from generation of revenue to controlling of the fiscal deficit. The criticality of this exercise has ensured that it is subject to constant evolution striving for financial efficiency, better outcomes, increased inclusiveness and stability in the national economy. But despite these efforts, challenges like financial resources crunch, administrative gaps and institutional issues have created persisting weaknesses in the Budgeting process.

Overcoming these weaknesses requires reforms in public financial management systems and processes in general and budgeting system in particular to improve fiscal discipline, enhance prioritization for allocative efficiency, and improve public service delivery. Though, achievement of desired socio-economic outcomes goes beyond the budgetary exercise, but budget via its connection to the public and accountability hinged to the parliament can push beyond its boundaries towards realization of the desired objectives.

TOPIC AT A GLANCE

Objectives

- Rapid and balanced economic growth
- Social Welfare
- Redistribution of income
- Reallocation of resources
- Economic stability
- Public accountability of funds
- Managing public enterprises

Evolution of the Budgeting Procedure in India

Year	Developments
1968	Ministries started bringing out a Performance Budget
1983	Zero based budgeting was adopted by the DoST, later made compulsory for all ministries
1996	Introduction of Participatory budgeting , first by the Kerela Govt.
2003	Adoption of FRBM Act
2005	Outcome Budgeting was introduced
2007	Inclusion of Gender Based Budgeting
2014	Abolition of Planning Commission and removal of distinction between Plan and Non Plan expenditure
2016	Merger of Railway and General Budget and advancement of budget by 1 month
2017	Rationalisation of CSS and their expenditure

GOVERNMENT BUDGETING

- A **process of estimating the availability of financial resources** and then allocating them to various activities of government according to a pre-determined priority.
- Plays a crucial role in the **Public Financial Management System**
- Represents choices, policies and philosophies of the government.
- Is a **manifestation of government's Fiscal Policy**.

Weaknesses in the Indian Budgetary Process

- **Outcome budget is yet to emerge as a robust fiscal instrument** to judge the performance of the government.
- **Hindrances in implementing Gender Budgeting**, due to which the size of gender budget has remained below 5%.
- **Issues in main streaming participatory budgeting.**
- **Changing course of deficit management** which shifted focus away from targeting revenue deficit.
- **Doubtful credibility of the budget creating distrust among public.**
- Abolition of Planning commission and creation of GST council led to **institutional gaps creating apprehensions and uncertainty for future.**
- **Parliamentary incompetencies leading to substandard scrutiny of the budget.**
- **Lack of Transparency and Accountability.**
- **Inadequate allocations in critical sectors.**
- **Other issues like delays in implementation of projects, ad-hoc project announcements and lack of focus on emerging issues.**

Reforms Needed to Address Above Weaknesses

- **Dealing with issues of Budget Credibility** through **Medium Term Expenditure Framework** facilitating sound macroeconomic forecasts and establishing a **Fiscal Council** to provide independent assessments of budget proposals.
- **Enhancing budget transparency and accountability** through steps like publishing a Pre-budgetary statement.
- **Rectifying flaws in the Gender Budget Statement.**
- Establishing an Independent **Parliamentary Budget Research Office** to bridge gap between the policies of the government and aspirations of general public.
- **Inclusion of Climate-responsive budgeting.**