

# DIMENSIONS OF PUBLIC EXPENDITURE MANAGEMENT

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"Free Enterprise was born with man  
and shall survive as long as man  
survives".

**-A.D. Shroff**

1899-1965

Founder-President

Forum of Free Enterprise

# **DIMENSIONS OF PUBLIC EXPENDITURE MANAGEMENT**

By

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In India, the subject of public expenditure has been relatively neglected in academic and policy studies and more so in terms of public attention and debate. Government budgets typically concentrate on annual variations and the book-keeping features and not particularly on content, impact and relevance. It is not only the sheer increase in the size of public expenditure and the magnitude of fiscal deficits of the Centre and the States (some 10% of GDP) that is a cause for concern. The productivity and impact of public expenditure are low in several sectors and priorities and perspectives are unclear.

The Prime Minister, in an address to the Institute of Chartered Accountants, has called for transparency in government spending and for a stringent monitoring of the end-use of public funds, specially those earmarked for the various development programmes of the Government. There is a need to demystify public expenditure. Awareness among citizens, who are also the tax-payers and stakeholders, needs to be built up, leading to opinion formation and more explicit expressions of citizens' viewpoints which in turn may contribute to the development of an overall perspective, if not consensus, on public expenditure.

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I should like to begin by referring to the size and composition of public expenditure, highlighting some facts which are known to observers of the fiscal scene but not to people at large in their capacities as taxpayers, presumptive beneficiaries and as citizens.

I shall then call attention to certain underlying issues which are not generally recognized, such as the trends in concepts and practices that have emerged, amounting in my view to a paradigm shift, and their macroeconomic consequences; the need for a medium term outlook going beyond the budgetary year; and the fundamental dis-equilibria and asymmetries that cloud the fiscal scene. I shall draw attention to the socio-political and developmental dimension of public expenditure. I shall refrain from giving readymade prescriptions. However I shall draw attention to certain elements of a possible holistic view, such as enhancing efficiency and effectiveness of public expenditure, imparting vigour to the processes of control in a democratic system and promoting greater awareness and indeed alertness, on the part of the citizens.

Since the eighties, the Central Government expenditure has been almost doubling every five years. In the first half of the eighties it grew by 136% and in the second half by 98%. In the first half of the nineties it grew by 74%. As for the State Governments, they had a revenue surplus of Rs.1485 crores in 1980-81. Their revenue deficit in 1996-97 was Rs.15855 crores. The liberalisation process has made little change in limiting the cascading of public expenditure. There are no staff reductions in Government. Buoyant growth and consequently buoyant revenues are not yet in evidence.

Absolute figures may not necessarily convey much. They have to be adjusted for inflation, increase in population and several other parameters. The Central Government expenditure is now in the range of 17% of GDP. The Central fiscal deficit went up to 8.3% of GDP in 1990-91 and the attempt is now to keep it around 5 to 6%. The combined fiscal deficit of the States is about 3.2% of GDP.

The basic question is how well the money is spent, what benefits the citizens derive from the increased public expenditure and what it means to the economy. The increase in recent years is mostly accounted by increases in salaries, interest payments and subsidies. But what has happened to the proportion of population below the poverty line? Where does the country stand in respect of the various components of the Human Development Index? What kind of infrastructure has the country built up? On such counts public expenditure has clearly missed targets. This is a matter for serious reflection by the nation.

### **Emerging Paradigm**

I shall now refer briefly to certain trends in concepts and practices.

The talk is now about the fiscal deficit and not the revenue deficit. The concept of a fiscal deficit is relevant in relation to the impact of the total budgetary deficit on the economy. But is the revenue budget irrelevant and obsolete? If so, what are the implications?

Large scale public borrowing. Even revenue budget activities, plan and non-plan, are financed by borrowing. The borrowing is at commercial rates of interest. The interest burden is over 25% of the Centre's revenue budget. Over the last three years, the interest burden of the State Governments has increased by 50%. According to the Comptroller and Auditor General, not only did borrowings of the Central Government account for over half of the Government's receipts, as much as 86% of the internal borrowings were utilised to meet debt service obligations. Is the country falling into a debt trap? Will there be a situation in, say ten years' time, when the total revenue budget will be used up for interest payments?

Government has become a competitor in the money market. The Government's share in the debt market has always been

predominant. Financial institutions connected with the Government take another big share. The corporate sector has a share of one per cent in the debt market. If the savings rate remains stagnant, will the Government crowd out productive sectors like industry and services? If public borrowing continues, what would be the effect of the upward pressure on interest rates on industrial growth?

With the distinction between revenue and capital budgets getting diluted in so far as covering deficits is concerned, capital expenditure takes a backseat to a predatory revenue deficit. Public capital formation has slowed down in recent years. Any attempt to make a capital asset yield a stream of revenues is no longer seen as compelling. What are the ways to accelerate capital formation, particularly for infrastructure development?

Privatisation of services or production units is another element of the emerging paradigm. Do conditions for large scale privatisation exist? What are the limits to privatisation? What relief is possible for the government budget in terms of current expenditure or future commitments? The experience of different countries with privatisation is mixed.

Prioritisation is an issue which needs particular attention. Priorities will no doubt keep changing. Views on priorities vary with governments and political parties. How could a consistent and sustained scheme of priorities basic to human development be ensured? Instead of their changing from year to year, could a medium term perspective be adopted? The Directive Principles of State Policy of the Constitution refer to the raising of the standard of living of the citizens and makes particular mention of nutrition, health and education. These requirements seem to be getting less and less budgetary support.

A disturbing feature of the last two decades or so is that there is no demarcation of or restraint on what types of activities would legitimately belong to the domain of public expenditure.

Executive discretion appears to be wide. Should there be a shared view or code of conduct on norms, if so what they would be, who frames them and what are the consequences of deviation from them? The Constitution only refers to public purposes and expenditure within the ambit of the laws and the Constitution itself. Different countries appear to follow different approaches. Most European countries consider social security and social services as an essential part of the budget, while the United Kingdom over the last two decades followed a different approach. The United States of America appears to fall somewhere in between.

Subsidies have become a permanent fixture. It can be said that the objective of public expenditure is after all a direct or indirect redistribution of income. But how can a line be drawn between 'good' subsidies and others? How can their perpetuation be avoided? How can transparency be ensured? Could the Central and State Governments be called upon to bring out White Papers on the subsidies that they give, their impact and their economic and budgetary implications?

There are more and more reports of politicisation and corruption in public expenditure. From an economic point of view, they lead to inefficient and costly use of scarce resources.

I believe that all these considerations I have mentioned amount to a paradigm shift. Others may or may not agree. It may be argued that concepts and practices must evolve according to circumstances and necessity mothers innovations. But the question is whether such concepts and practices are adopted ad hoc or whether they are the result of a conscious, articulated and possibly consensual effort. The issues, I think, require close examination and an informed debate.

The macroeconomic impact of public expenditure is what makes the need for an orderly and articulated approach to changing concepts and practices imperative. It is now recognized that

high fiscal deficit in the Indian context means high and increasing interest payments, low public sector investments, lower expenditure on social services, high levels of borrowing and interest rates, high margins in banks and crowding out of private sector investments.

Two aspects which are not adequately recognized are the following. Firstly, the increasing fiscal overextension by the states does also affect the macro-economic situation. Secondly, there is an inter-dependence between central and state finances and the time has come to take a more integrated view of the fiscal scene. The terms of reference of the Eleventh Finance Commission require it to review the state of the finances of the Union and the States and suggest ways and means by which the Governments, collectively and severally, may bring about a restructuring of the public finances so as to restore budgetary balance and maintain macroeconomic stability. It is hoped that the Commission will set in motion a process of collective thinking and action. (This has not materialised – Editor).

What is the prognosis for public expenditure in the medium term? Budget documents and budget speeches typically deal with the annual budget variations and matters of immediate concern. A Finance Minister may have to deal with matters of the moment rather than matters of moment. Would it not be useful and indeed necessary that a rough forecast is made of the revenue and expenditure over the next, say, five years? Admittedly, such forecast would be indicative. But there are some merits in such a procedure. It may contribute to more stable expenditure policies replacing the uncertainties of annual allotments for projects and the scramble to spend funds over what will effectively be a nine month period in a year. Also, the process is more important than the product in that there will be a specific application of mind on the trends and prospects of revenue, expenditure and the fiscal gap, even while making proposals for a specific year.



If one attempted a five year projection now of the Centre and State expenditure, one will find the expenditure on salaries following the rate of inflation like a shadow and of debt servicing overwhelming new borrowing. It has been estimated that over a five year period the revenue deficit of the Centre and the States alone will account for a debt of nearly Rs.500,000 crores. Net borrowing will have to increase substantially, as will the interest payments. As regards subsidies, the prospective increase is anybody's guess unless there is hard and realistic thinking.

On subsidies I wish to pose a question which may be dismissed out of hand as unrealistic. But it is a case of hope getting the better of experience. This pertains particularly to competitive subsidy measures on the part of the States, e.g. for free electricity for agricultural consumers. Even as they engage in competitive subsidisation, States do realise the unviability of such measures, but they may not want to take steps which will rank them down in the scale of generosity. The question invariably asked is, "Who will bell the cat?" If, however, all States (and the Centre) get together, review the policies in relation to the subsidy and suggest modifications or abolition (for example, no free electricity during summer months), the hands of the individual Chief Ministers will be strengthened.

For this and other reasons, a review by Central and State Governments and equally importantly a public debate on the parlous state of Public Expenditure has become necessary. Such a review can no longer be postponed if the "consolidated fund" is to be saved from becoming, what the unkind may call, a "dilapidated" fund. Is there merit in an Expenditure Policy Resolution for the next decade, evolved out of consultations between Central and State Governments?

What is a matter for national concern and collective introspection is what I may term as the fundamental disequilibria as asymmetries that lie beneath the fiscal system.

I shall refer to some of them. Firstly, the State seems to be becoming more and more an employer and a borrower and except for the income transfer implied in subsidies, less and less a provider of services that improve the standard of living and the quality of life of the people. Secondly, the growth of revenues depends on the growth of the economy while expenditure on major components such as salaries, interest on borrowings and subsidies has its own relentless and autonomous momentum. Economic growth needs to be at centre stage on this ground too. Thirdly, public expenditure is expected to bale the economy out of recession, while at the same time, the fiscal deficits need to be reduced to avoid, among other things, the macroeconomic consequences.

### **Matching functions and finances**

A major asymmetry is the inverse relationship between financial availability and functional responsibilities. While an integrated national economy requires the centralisation of taxes, like income tax, excise duties and custom duties, the responsibilities for enhancing the welfare of the citizen more directly, such as education, health, water supply, sanitation and local roads need to be discharged at the level of the State and the local bodies. This dichotomy is sought to be bridged by vertical transfers, but it appears that the bridging, is far from complete, whether between the centre and the states or as between the states and local bodies or between more developed and less developed States and regions. The development content of Public Expenditure is critically dependent on the vertical transfers.

The matching of functions and finances has not been attempted systematically; matching, eventually is the responsibility of the transferor as well as the transferee. The work of the Finance Commission and the State Finance Commissions should address more closely the balance between functions and finances. It will be necessary to adopt some norms for the levels of various services to be rendered and match the finances accordingly.

One may note in passing that the Finance mission addresses distribution issues based on an assessment of projections made by the States. But it does not appear that any monitoring has taken place whether the money has been spent as projected or differently.

There are also imbalances in admittedly priority areas whether in Central and State budgets. The emphasis on science and technology has not been matched by budgetary allocation in recent years. In the case of infrastructure, two areas where investments have been below desired levels in the past fifteen years are roads and urban facilities. There are also imbalances like schools without sanitary conveniences, hospitals without equipment and so on.

### **Efficiency and Effectiveness**

Questions of productivity in government activities and the efficiency and effectiveness of public expenditure have not received any sustained attention. Spending a given allocation in a financial year has been equated with efficiency and spending more of it in subsequent years with effectiveness. Achievement of financial targets has been taken as the yardstick of success. Impact analysis and beneficiary satisfaction do not appear to be matters of concern.

The issue of 'quality' in public expenditure has several dimensions, particularly depending on the type of expenditure. For example, is the objective of a particular expenditure achieved? Is a service properly rendered and do its benefits reach the beneficiary? Is there value for money? 'Quality' in public expenditure is an issue which needs debate, definition and operationalisation. Can one borrow from concepts such as 'Quality Circles' and 'ISO 9000'?

There are several glaring instances of inefficiencies. For example, in a meeting of the Public Expenditure Round Table on Public

Expenditure on Infrastructure Development, it was noted that there is a danger of India's infrastructure aspirations being thwarted by poor implementation. Several shortcomings were brought to attention, such as lack of prioritisation, inadequate project formulation, cost overruns, long delays in project implementation, and so on. How can concerted ameliorative measures be taken?

Better utilisation of existing assets, whether in infrastructure or elsewhere need priority attention. This itself will make a substantial difference to the infrastructure scene.

In what way can tools such as economic classification of budgets and performance budgets be sharpened and put to use? What changes are required in financial and administrative procedures? The UK Government in the early eighties brought out a White Paper on public expenditure and followed it up by several measures. One of them was to set measurable outputs for each department. Why cannot such steps be initiated?

At a procedural level, several actions can be thought of: for example, a sunset rule to activities; transparency and user-friendliness in presentations of budgets and programme documents; the possibility of putting money unutilised in a financial year into a deposit of advances; a statement of projected income flows for major items of capital expenditure; and specific allocations for maintenance and utilisation of existing assets. Budgeting and financial procedures and practices would need a fresh look.

### **The role of democratic processes**

Democratic processes and their checks and balances appear to have failed to stem the tide. Public expenditure is admittedly different from the expenditure of a private company in terms of accountability. The actors are diverse, the constituents are diffused and direct accountability is difficult to establish. During

periodical elections, other issues crowd out matters relating to the possible misuse of the instrument of public expenditure. There is hardly enough time in the legislatures to discuss demands for grants in any depth. Most demands get approved by the guillotine procedure. Parliamentary Standing Committees were created as an answer to this problem. Are they working effectively? Interest in the issues that such committees raise does not appear to be sustained, either on the part of the Government or of the legislators that raise them. In general, most legislators appear to be content if the projects of their constituencies are attended to. Public Accounts Committees do a post mortem as do the audit reports. How far have they been able to make a sustained impact? How far does the executive government take or is impelled to take those reports seriously?

### **Awareness generation**

While political will is needed to take steps to enhance the efficiency and effectiveness of public expenditure, that will can be brought about by an alert public which, as the beneficiary, can give a feedback to ministers and legislators. Awareness generation has several dimensions.

First is the transparency and userfriendliness of documents. Government documents, budgets, administration reports, etc. need to be redesigned and demystified. How can this process be started? How can the access to information in this respect rendered easier?

Second is the initiation of informed public debates on general issues and sector specific programmes, with the involvement of the end-users. Possible suggestions for improvement can come from the end-users and professionals. The initiative of the establishment of a group called the Public Expenditure Round Table (PERT) in Chennai is a step in this direction.

Third is the spreading of awareness among the younger

generation. What steps can be taken in this respect? Can university students play a role in this respect?

Fourth is government departments themselves presenting their programmes to beneficiaries and getting their feedback.

In all the above, the media must play an important role.

### **Concluding remarks**

The *problematique* of public expenditure constitutes a creeping malaise in the national economy. Some of its major dimensions are the lessening of developmental content; the threat to macroeconomic stability; inherent asymmetries; inarticulate paradigm shifts; and the need for efficiency and effectiveness. Political will is needed to overcome the malaise. This will must be forged, notwithstanding the ear of coalition governments. Public expenditure is too important to be left to governments alone. There is a need for a national debate and consensus on this subject.

*The views expressed in this booklet are not necessarily those of the Forum of Free Enterprise.*

**"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".**

**-Eugene Black**

## FORUM OF FREE ENTERPRISE

The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions and other means as befit a democratic society.

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Published by M.R. Pai for the Forum of Free Enterprise,  
"Peninsula House",

235, Dr. D.N. Road, Mumbai 400 001.

Laser Typesetting by

SHARPLINE CREATIONS, Tel.: 262 6424

and printed at Vijay Printing Press,

9-10, 3rd Floor, Mahalaxmi Industrial Estate,  
Gandhi Nagar, Lower Parel, Mumbai 400 013.