

Module 11 : Financial Administration

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Chapter I

Introduction to Financial Administration

A. Introduction to Financial Administration

Finance is the life blood of all the socio-economic organizations. Financial administration relates to the system which generates, regulates and distributes monetary resources needed for the sustenance and growth of organizations. Financial system is a subsystem of the administrative system.

Lloyd George once remarked that 'Government is finance and rightly so because no administration can function without finance. The success of administration depends upon the availability of finance. Any Government which has worked out and is employing a satisfactory system of Financial Administration has gone a long way towards putting the administration of its affairs upon an efficient basis. Conversely, any Government which has not done this cannot possibly have that economical and effective management of its affairs to which its citizens are entitled.

Financial Administration is one of the important aspects of Public Administration. Hoover Commission (U.S.A.) and Administrative Reforms Commission, India, rate it as the core activity of administration.

B. Relationship between Financial Administration and Public Administration

In the words of J. Gaston, "Financial Administration is that part of Government Organization which deals with, (i) collection, preservation and distribution of public funds; (ii) the management of credit operations on behalf of the State, and (iii) general control of the financial affairs of the public house hold". It is hence apparent that both, Public Administration and Financial Administration are very intimately connected.

According to Dr. L.D. White, "Every administrative act has its financial implications, either creating a charge on the treasury or making a contribution to it. Nothing can be done without spending

the money at the very minimum; at the least the wages of the employees or the salary of the officials etc. are to be paid. At the same time, available financial resources set a maximum limit on administrative activity as a whole and on each of its separate parts. The management of finance is, therefore, one of the inescapable responsibilities of administrators, since the financial administration and public administration, as a matter of fact, are closely intertwined. According to MJK Thavaraj: financial administration is similar to the circulatory system in complex living organisms". it is hence an important subsystem of the administrative system which is itself an integral part of the political and socioeconomic system.

C. Scope of Financial Administration

Financial Administration as a discipline deals with finance of the State *i.e.* public finance and dwells upon '*principle and practices*' for the proper, economical and efficient administration of the finance of the State. Practically as **Jeze Gaston** put it, it is '*that part of Government organization which deals with the collection, preservation and distribution of public funds, with the co – ordination of public revenues and expenditure, with the management of credit operations on behalf of the State and with general control of the financial affairs of the public household.*'

Thus Financial Administration deals with the theoretical as-well-as practical aspects of State Finance. There is a view according to which the '*Components of Financial Administration are budgeting, accounting, auditing, purchase and supply management, tax-administration and treasury management.*'

Financial administration includes all the processes involved in collecting, budgeting, appropriating and spending public money, crediting income and expenditures and receipts and disbursements; accounting for assets and liabilities and for the financial transaction of the government and reporting upon income and expenditures, receipts and disbursements, and the conditions of funds and appropriations.

Operationally, Financial Administration consists of broadly three types of activities

- (i) Fiscal Policy
- (ii) Fiscal Accountability

(iii) Fiscal Management

(i) Fiscal Policy

Fiscal Policy is the technical aspect of financial administration and includes matters dealing with taxation. It includes, hence, matters like taxation theory, the debt theory, the social implications of taxes. In other words, the contents of this area have been borrowed from Economics.

(ii) Fiscal Accountability

Public Administration requires that the administrators not only act honestly but also they should have evidence to show that they acted honestly. The concept of Fiscal Accountability is meant to ensure just this only. The accounting has to be done in proper form, prescribed rules and procedures are supposed to be followed and the principles of wisdom, faithfulness and economy to be observed while spending the money. The system of Audit and various financial legislations are there just to ensure all this.

(iii) Fiscal Management

Fiscal Management is a dynamic process involving a continuous chain of operations which include-

- a. Preparation of the Budget.
- b. Securing legislative sanction for the Budget
- c. Execution of the Budget
- d. Management of the treasury i.e. safe custody of the funds raised etc.
- e. Accounting.
- f. Reporting System
- g. Auditing

D. Principles of Financial Administration

The notable principles of Financial Administration are being briefly discussed below:

(i) *Unity of Organization*

Unity of organization is the very basic requirement of the sound system of Financial Administration.

According to **Pinto**, *'The more unified the different agencies of the Government are and the more centralized the responsibility of the hierarchy of officials, the more efficient is the administration. This centralization does not mean that everything is done by a few at the top; details must be left to the discretion of the subordinate officers. But it does mean that the work of the different agencies is coordinated and rightly evaluated in any financial schedule of the Government.'*

(ii) *Organization according to the System of Government*

It is essential that financial institutions and departments are organized according to the system of Government. In a Parliamentary democracy like India, the system of Financial Administration must be organized and operated in a manner as to secure compliance with the will of the legislature as expressed through the *Appropriation Act* and *Finance Act*.

(iii) *Prompt, Simple and Regularly in Functioning*

It is a condition precedent for an effective Financial Administration to possess simplicity, promptness and continuous functioning. It has been opined that simplicity is required to economize and make the system understandable to the people. Promptness has not always been a virtue of Governmental Financial Administration. It is obvious, however that, a Government can not afford to give its decisions without due thought and regard for its policy in the past or the repercussions to its decision in the future. Regularity of functioning is essential to efficiency A Government department can not afford to function at intervals, for administrative work is continuous.

(iv) *Effective Control*

To ensure efficient Financial Administration, there is an appalling need of effective and simple system of control

over it. It has been rightly pointed out that, *'the stability of the country, the continuity of policy, efficient execution of sanctioned plans, and careful handling of finance are in great measure due to the men of services who by their ability and experience are in an excellent position to put large schemes into execution. Even if the system of administration is not upto the standard, first rate personnel can easily make-up for the defects; on the other hand, not even the best devised system with all its checks and controls can be effective if the personnel of the administration is inefficient or corrupt, for the public spirit of the servants of the State is the spirit that gives life to dead rules and regulations.'*

E. Agencies involved in Financial Administration

Financial Administration involves all the functions listed above (under the head scope of financial administration), which are performed by the following agencies:

- (i) The Executive.
- (ii) The Legislature.
- (iii) The principal financial officers in the administrative departments.
- (iv) The audit organization
- (v) The committees of the legislature
- (vi) Some independent organizations

(i) *The Executive*

The Budget estimates originate from the operating agencies, as they alone know their sources of revenue and the needs for the ensuing year. These estimates reach the Chief Executive through various departmental channels. The Chief Executive is responsible for formulation of the financial policy of the Government and the preparation of the estimates of the expenditure and revenue for the ensuing financial year. He is assisted in this job by a central department which in Britain is called the Treasury and in India is known as the Ministry of Finance.

(ii) *The Legislature*

It is a well established democratic principle that no tax can be levied or collected and no expenditure can be made by the Government except with the previous consent of the Parliament. The executive makes the demands and the legislature grants them. The power of authorizing the expenditure usually lies with the lower chamber (or popular chamber) of the Parliament, wherever there is a bicameral legislature.

(iii) *Principal financial officers in administrative departments*

As soon as the budget is passed by the legislature, the controlling officer who is usually the head of the department allocates the funds to the disbursing officers who are responsible for the disbursement of the money. It is his duty to ensure that no expenditure exceeds the amount voted by the legislature and also to ensure that the amount spent by an officer does not exceed the amount for which that officer has been authorized to spend. In Britain, the Head of the Department is also required to maintain Accounts with himself on behalf half of the Treasury. However, in India, the Head of the Departments are not responsible for account keeping.

(iv) *Audit*

The auditing agency in India is headed by the Comptroller and Auditor General of India. The chief purpose of audit is to ensure that the money drawn from the exchequer should be in conformity with the provisions of the Budget. Through audit, accounts are examined and it is ascertained whether the money spent was available to the authority who spent it; whether it was spent according to the rules and regulations; whether it was judiciously spent and spent for the purpose for which it was sanctioned by the legislature etc. The Audit Report hence points out to the legislature the cases of expenditure contrary to the grants made by the legislature.

(v) *The Committees of the Legislature*

There are three committees of legislature dealing with

financial matters. They are –

- (a) Estimates Committee
- (b) Public Accounts Committee
- (c) Committee on Public Undertakings

Since Parliament itself is a large body and cannot exercise the control over the budget very effectively, these committees are constituted to exercise control over the financial matters on behalf of the Parliament. They examine the financial matters of the government and it is their report which is discussed by the Parliament. Such committees, however, do not exist in some of the countries which are following the Presidential System of governance e.g. USA. In addition to these committees, there are 17 Department related Standing Committees which now oversee the budget of each and every Ministry and these Committees present their reports to both the Houses of Parliament.

(vi) Some Independent Organizations

There are some independent agencies, out of the control of the government that tender advice to the government about the prevailing economic trends within the country. Though budget is kept secret from them, their views are however, often utilized while formulating the budget. For example Institute of Finance Planning is such a body.

Chapter II

The Budget

A. The Concept of Budget

"A Budget, According to Dimock, "is a financial plan summarizing the financial experience of the past, stating a current plan, and projecting it over a specified period of time in future. Taylor defines the Budget as "a financial plan of the government for a definite period". The following are four essential features of a Budget.

- i) It is a statement of expected revenues and proposed expenditure.
- ii) It requires some authority to sanction it.
- iii) It is for a limited period only, generally one year.
- iv) It also sets forth the procedures and manner in which the collection of revenue and the administration of expenditures is to be executed.

B. Budget as a Tool of Financial Control

- i) For Parliament, the budget acts as an excellent instrument with which control and accountability can be enforced on the government. The Parliament exercises financial control due to the fact that all the demands for grants in the budget need to be supported by the explanation of purpose by the government. Parliament, according to the constitutional provisions, can decrease the amount asked for by the government or it may refuse to pass the whole budget altogether. The Parliament has control over the execution of the budget through executives because in Parliamentary System, the executive is a part of legislature.
- ii) The budget acts as an index of performance of the government against which the performance of the government in the previous year can be evaluated in terms of achievement of goals and policies.
- iii) It is an excellent tool of administrative control since the

administrator knows at the start of each activity, the maximum amount of resources that can be spent on a particular activity.

- iv) The budget is an indicator of the total health of the economy in the current scenario. Hence it is the best instrument that can provide steering control to the overall development process of a country.
- v) It is well known that control over the Finances provides control over all other aspects of administration. For example, even the personnel policy of a government can be dictated by the controlling agency e.g. the Parliament, by refusing to provide extra money for the salary of the fresh recruits.
- vi) Budget reflects one of the most important economic principles i.e. one should spend only according to the resources available in hand. Hence, budgeting helps to control the extravagance on the part of the executives. The very fear that somebody will be checking the accounts during audit stops him from misusing the money.

C. Budget as an Instrument of Socio-Economic Policy

Directive Principles of State Policy given in the Indian Constitution provide broad outlines for investment in the area of social welfare activities. These objectives outlined in the Constitution are achieved through adjustment of the priorities and emphasis accorded to various heads and sub heads in the budget. The budget is an important instrument of socio-economic policy in the following ways:

- i) The pattern of spending envisaged in the budget reflects the priorities of the present day government. An analysis of these patterns over the years reveals the shift in the priorities of the government over the years. For example, a cut in the spending in the social welfare sector indicates that for the time being the social welfare is not the priority of the government.
- ii) The Fiscal Policy declared in the budget, indicates the pattern of taxation in the country. The taxation rates are an effective tool to control or curb some practices in the

country. For example high rate of tax on a product e.g. cigarette indicates that the government wants to curb its consumption for the better health of the people. Similarly high rate of excise on liquor tends to limit its consumption without taking an extreme step like banning it which would deprive the Government of all the revenue that comes from liquor. Differential rates of taxation e.g. Progressive Taxation tends to protect small scale sector of the economy and tends to bring the rich and the poor of the economy closer in economic terms. On the other hand tax exemption on something e.g. savings tends to enhance the savings which is then utilized by the Government for the socio-economic development of the country.

D. Budget as a Tool of Management

Budget is an excellent tool of administrative management. Budgeting is one of the seven activities in an organization suggested by Gulick & Urwick as POSCORB. It is important to note that all the other six functions of the Management in an organization come to a halt in the absence of finances and hence it can be said that all of them can be achieved partially or completely through Budgeting. For example planning is inherent in budgeting, as budget itself is an annual financial plan. Demand for more staff is reflected in the budget, as more amounts needs to be sanctioned for the fresh recruits to meet their salary bill and to meet the expenses which are consequent to the creation of new administrative institutions and fresh staff. Similarly coordination can be achieved through budgeting by having a system of centralized financing in the budget etc.

E. Principles of budget making

A practical experience of many countries in the field of financial administration has led to the evolution of certain universal generalization akin to the 'Principles of Administration' to which the budget should conform. These principles can however be divided into two distinct categories –

- (i) Political Principles.
- (ii) Technical Principles.

(i) ***Political Principles of Budget Making***

(a) **Responsibility of the Executive:**

The budget preparation is mainly the responsibility of the executive. It is a well accepted principle that no demands for grants can be made except on the recommendation of the Executive. The legislature on its part can reduce the amount before sanctioning it; but it cannot increase the amount because the Chief Executive who is the actual spending authority is the better judge of how much money is required for a particular purpose. Further, if more amount is given to the Executive than what it needs, it cannot be made responsible for the money it did not need and hence it would obviously lead to wastage and extravagance.

(b) **Executive Discretion:**

The Executive must be given the power to allocate and reallocate the money from one minor head (not the major head) of expenditure to another minor head of expenditure. Keeping in mind the exigencies that often come at the time of execution of the budget, he should also have the power and means to meet the financial emergencies through the use of contingency fund. The provision of a contingency fund of India is a fine example of executive discretion in financial affairs.

(c) **Annuality of the Budget**

The legislature should grant money to the Executive for one year at a time because a year is a reasonable period of time for which the legislature can afford to give financial authority to the Executive. It is also the minimum period which is necessary to execute a financial program. However, it should be understood that annuality principle does not mean that there should be no long-term planning. The long-term plans are often prepared in some countries, but they do not involve grant of actual funds to be appropriated

during the entire period of the plan by the legislature; though the legislature may be called upon to approve the plan in principle and its broad outline, as is done in the case of Five Year Plans in India. The Annual Budgets are then formulated to translate the Five Years Plans into action.

d) Single Budget

The Government should ordinarily have a single budget incorporating all revenues as well as expenditures of the Government. A single budget presents to the people a clear cut picture of the financial transactions of the Government as a whole. However, in case of certain exigencies some deviations in the form of Extra ordinary Budgets for special purposes may be provided; but the number of such extra ordinary budgets should be limited and should not be allowed too often to be used. In some countries including India, for historical reasons, the principle of single budget is violated. India has had a separate budget for Railways since 1924 which continues even today.

e) Treasury Control

The control of treasury is an important political principle and the best system for achieving a direction and internal control. It can be seen in operation in the working of the British Treasury in England, where it concerns itself not only in regard to the preparation of budget but also exercises day-to-day supervision over the flow of finances to the operating agencies.

(ii) *Technical Principles behind the Budget Formulation*

a) Balanced budget

Normally, the budget must be a balanced one. Deficit budgets are risky (since it can lead to inflation). Yet, a little amount of budget deficit is acceptable, because it helps fight trade depression. A deficit budget means more spending on public works which increases the

purchasing power of the people, which in turn stimulates demand and hence an increase in production results which fights the depression.

b) Cash basis

Estimates should be on cash basis in the budget and not on revenue basis.

c) Distinct revenue and capital budgeting

The revenue and the capital portion (which consists chiefly of borrowings) should be kept distinct and should be shown in two separate parts of the budget known as the current or revenue budget and the capital budget. The reason being that the receipts from loans, deposits, sale proceeds of the property etc. are occasional and not recurring. Similarly on the expenditure side also, capital outlays on works, debt payments, paying back the deposits etc., are also occasional and not recurring. The consequence of not keeping the recurring and capital items separate would confuse the financial picture. Current expenditure might, in that case, be met out of the loan funds and a balance or surplus might be shown when really there is a deficit. Hence the Revenue and capital parts of the budget must be kept distinct and should be balanced separately and then the overall surplus and deficit should be found out.

(d) Gross budgeting

Budgeting should be gross and not net. Both the receipts and the expenditure should be fully shown in the budget and not merely the resultant net position. For example, if the receipt under a particular head is Rs. 45 crores while the expenditure under this head is Rs. 120 crores, the budget should show both the expenditure of Rs.120 crores and the receipt of Rs. 45 crore and not merely the net expenditure of Rs.75 crores. If the refer practice is followed this would mean that the executive would approach the legislature for the grant of Rs. 75 crores only for the

expenditure under that head and hence would deprive the legislature of its control over the expenditure of Rs. 120 crores which the executive met partly out of receipts.

(e) Avoiding under or over estimation

Estimates should be as exact as possible and an effort should be made to keep the estimates as near as actuals by taking into account the provisions of depreciation, inflation, devaluation etc. An underestimation of expenditure may lead the government into serious troubles. On the other hand overestimation of expenditure may lead to the imposition of unnecessarily heavy taxes on the public. Generally actuals of the current year are taken as the estimates for the next year as a starting point.

f) Synergy with account heads

The estimates should correspond to the form in which accounts are to be kept. This helps in budget preparation, budgetary control and in the keeping of the accounts. The budgetary heads should be the same as those of the account heads.

g) Rule of Lapse

It is the last budgetary principle. According to this rule "No part of the grant that is unspent in the current financial year, can be carried forward for the future". If this rule is not applied in practice and the unspent money is made available to the executive in the succeeding years, then it would dilute the financial control of the Parliament, since the Executive then can continue to spend the accumulated and unspent balances. Till such money lasts, there would be no need for the executive to go to the Parliament for the fresh sanction of money.

Chapter – III

The Budgetary Process

A. Introduction to the Budgetary Process

The budgetary process in any country involves 5 different operations viz.

- (i) Formulation of the Budget by the executive
- (ii) Enactment of the budget i.e. its approval by the legislature in the form of finance bills and appropriation bills
- (iii) Execution of the budget i.e. enforcement of the finance and appropriation bills
- (iv) Accounting and Auditing of the expenditure and revenue collection; and
- (v) The legislative control of the budget in the form of its committees.

B. Budgetary Process in India

The preparation of the budget by the disbursing officers of the department starts 6 to 8 months before the commencement of the next financial year. In August-September, the Accountant-General sends prescribed forms for the estimates of revenue and expenditure separately to the Heads of the various departments. The Heads of Departments send these forms to the disbursing officers who prepare the preliminary estimates. The task of taking preliminary estimates is not a simple arithmetic exercise, as the circumstances of no one year are exactly similar to the earlier ones and hence ground realities and the administrators judgment has to be taken into account. While preparing the estimates, the local officers are required to fill in four columns of the prescribed form ;

- (i) Actuals of the previous year;
- (ii) Sanctioned estimates for the current year;
- (iii) Revised estimates for the current year; and
- (iv) Budget estimates for the next year.

These estimates are finally prepared by the HODS in 3 parts, namely, Part I, Part II A and Part II B. Part I of the estimates

relates to the revenue and the standing charges e.g. TA, charges on permanent establishment etc. Part II A relates to the charges required for the existing schemes which will continue during next year i.e. such schemes for which the sanction has already been taken in the previous budgets. Part II B relates entirely to the new schemes of expenditure.

The second step in the budget preparation in India is the scrutiny and review of the estimates by the controlling officers of the concerned departments, who are generally the Integrated Finance Officers (or the HODs in case there are no IFO provided to the department). The scrutiny and review is purely of an administrative type and the relative importance of the proposals is judged in the light of the possible grant for the department as a whole. He, therefore, rejects some of the estimates and consolidates the estimates of the department by the beginning of October. I.F.O. also advises about the documental support that is required with the proposals and estimates in Part II B of the Budget estimates.

Part I of the estimates is now submitted directly to the Accountant General who then also adds to it the debt obligation, deposits and remittances expected in the next year and consolidates it and sends it to the Finance Department of the Ministry of Finance. The Finance Department scrutinizes the estimates from purely financial point of view i.e. economy, availability of funds etc. The Part IIA and Part II B of the budget estimates are sent directly to the Finance Department through the concerned administrative departments. The scrutiny of estimates regarding the new schemes by the Finance Ministry is of very elaborate nature. The following questions are asked for their complete satisfaction before including these parts into the budget

- (a) Is the proposed expenditure really necessary?
- (b) If so, how have we so long done without it? Why do we need it now?
- (c) What is done elsewhere, for example; in other departments?
- (d) What will it cost and where from is the money to come?
- (e) Which other item of expenditure will go short of funds as a consequence of it?
- (f) Are new developments in the "near future", likely to render it unnecessary?

The Ministry of, Finance then prepares the estimates of income and

expenditure of the Government of India. Estimates of income i.e. of revenue are prepared by it in consultation with the Central Board of Direct Taxes (CBDT) and Central Board of Indirect Taxes (CBIT) along with the estimates sent by the respective departments. On the basis of the estimated expenditure, proposals regarding taxes are made in the budget. In other words, the entire budget is rearranged in 3 distinct parts, the contents of which are as follows

(i) First Part

The first part of the proposed budget consists of the general economic survey giving the comparative review of the public expenditure of the current year, previous year and the projected expenditure for the next year. However, an overall view of the state of economy in the year that has just ended is given in detail in this part.

(ii) Second Part

This part gives estimates of revenue at the current rates of taxation. It also gives the gap between the total income and total expenditure of the Government.

(iii) Third Part

The third part of the budget contains the proposals to cover the budget deficit i.e. new taxes etc. that are proposed in this part of the budget. This third part of the Budget Draft is actually added by the Finance Minister in consultation with the Prime Minister.

The budget consolidated in this form is ready by the month of December and the next step in the budgetary process is its approval by the Cabinet. The Finance Minister examines the budget estimates somewhere in January and in consultation with the Prime Minister prepares his financial policy with regard to taxation etc., which constitutes the Third Part of the Budget. After this exercise is over, the budget is submitted to the Cabinet for joint consideration. It is necessary to discuss the budget in the Cabinet meeting because it is the Cabinet which is responsible for laying down the general course of policy. The Cabinet hence ensures that the election manifesto

of the political party in power and the policies of the Government are duly reflected in the budget. The Cabinet hence, may recommend some adjustments in financial and taxation policies etc., when the Cabinet gives its approval to the budget. The budget then is ready for being introduced in the Parliament.

C. Introductory and Passage of the Budget in the Parliament

So far, upto this stage, the approval of the budget was done by various authorities from technical and financial view point only. Policy approval of the budget was, however, only partially done at the time of its passage by the Cabinet. Now onwards the approval of the budget is done mainly from the point of view of policy approval and political approval. The legislature can reject some of the policies contained in the budget by the use of various cut motions.

The provisions of the Constitution dealing with the budget procedure in the Parliament are as follows:

- (i) **Article 112:** It is the President who has to get the annual financial statement prepared and causes it to be laid down before both the Houses of the Parliament. It also gives the list of expenditure that shall be charged on the Consolidated Fund of India.
- (ii) **Article 113:** Deals with the demands for grants. No demands for grants can be made except on the recommendation of the President.
- (iii) **Article 114:** Deals with the appropriation bills related to the budget. It states that no money can be withdrawn from the Consolidated Fund except under an Appropriation Act.
- (iv) **Article 110:** It gives the definition of the money bills. The passage of the budget in the Parliament is the same as the procedure described for the money bills i.e. budget also is a money bill.
- (v) **Article 117:** it deals with the definition of the finance bills.
- (vi) **Article 265:** Deals with the revenue collection. According to it

no tax shall be levied or collected except by the authority of law i.e. Executive cannot impose any tax without legislative authority.

- (vii) **Article 266:** Deals with the creation of Consolidated Fund of India and Public Account of India. All revenues received by the Government of India (except for those taxes that are assigned to the States), all loans raised by the Government and all moneys received by the Government in repayment of loans shall form one Consolidated Fund to be called "the Consolidated Fund of India". The other Public Moneys received by or on behalf of the Government of India shall be credited to the "Public Account of India". (This includes fee for services, for example).

- (viii) **Article 267:** It empowers Parliament and the Legislature of a State to create a "Contingency Fund" for India or for a State, as the case may be. Accordingly the Contingency Fund of India has been constituted by the Contingency Fund of India Act, 1950. The Fund will be at the disposal of the executive to enable advances to be made, from time to time, for the purpose of meeting unforeseen expenditure, pending authorization of such expenditure by the Legislature by supplementary, additional or excess grants. After such authorization, the amount spent out of the Contingency Fund is transferred from Consolidated Fund of India to Contingency Fund of India. The reason for doing so is that executive is not empowered to spend money out of Consolidated Fund of India till he is authorized by an appropriate act, which may not be possible at times due to various reasons e.g. Parliament may not be in Session. Hence to meet exigencies, he can utilize Contingency Fund of India.

The introduction and passage of the budget by the Parliament is a very important activity of the Parliament and hence one full session of the Legislature is devoted exclusively for this activity because the budget proposals cannot be put into execution until they get political approval from the representatives of the people. Till then, no expenditure can be done out of the Consolidated Fund of India and also no fresh tax can be levied. The Budget Session of the Parliament starts with the presentation of the Railway Budget in the Parliament which is about one week before the presentation of the budget. The budget, before being presented in the Parliament, is sent for the signatures of the President by the Government so that it can be presented in the Parliament as a Governmental Bill (and not

as a Private Members Bill).

The budget in India is usually presented on the last working day in the month of February. This offers to the House a period of one full month to debate, discuss and pass the budget document. The presentation of the budget is preceded by the speech of the Finance Minister which gives information relating to the general economic conditions of the country, the financial policy to be followed by the Government, the explanation for the difference between the budget estimates and the revised estimates of the current year and explanatory memoranda which explains the new demands in short as well as some of the new schemes proposed in the budget. There is a convention that a large number of documents, reports and surveys, for example economic survey etc., are also presented along with the budget documents. The purpose of doing so is to enable the MPs to be in a better position to discuss the budgetary provisions. The budget speech of the Finance Minister is of great importance and is eagerly awaited not only by the business community but also by almost every section of the community.

The budget estimates are now discussed In the Parliament. This stage of "General Discussion" on the budget involves a very general nature of discussion and specific discussion on allocations and demands for grants etc. is not done at this stage. Only the impact of the budget on the economy, society etc. is discussed. The days allocated to this activity, according to the rules and procedures of the Parliament are, 4 days in the Lok Sabha and 3 days in the Rajya Sabha. The budgetary estimates for the sake of convenience are grouped separately into two parts i.e. estimates for the expenditure charged on the "Consolidated Fund of India", and expenditure charged on the "Public Accounts of India". Article 12 mentions the following expenditures as charged on the Consolidated Fund of India

- (a) The emoluments and allowances of the President and other expenditure relating to his office.
- (b) Salaries and allowances of the Chairman and the Deputy Chairman of the Rajya Sabha and the Speaker and the Deputy Speaker of the House of the People.
- (c) Debt charges for which the Government of India is liable including interest, other expenditure relating to the raising of loans abroad and the service and redemption of debt.
- (d) The salaries, allowances and pensions payable to the Judges

of the Supreme Court, Comptroller and Auditor General of India, Chief Election Commission etc.

- (e) The Pensions payable to, or in respect of, judges of any high court which exercises jurisdiction in relation to any area included in the territory of India.
- (f) Any sums required to satisfy any judgment, decree or award of any court or arbitration tribunal.
- (g) Any other expenditure declared by the Constitution or by the Parliament by law to be so charged.

The items mentioned above are not notable i.e. Legislators can discuss them but cannot reduce or reject them.

The Public Account of India includes funds like the state provident funds, depreciation and other reserve funds of the Government departments, Postal Savings Bank, Post Office cash and other savings certificates, postal life insurance funds and adhoc funds created by the Government by appropriation from revenue or otherwise, miscellaneous deposits and remittances etc. It is worth noting that none of the money lying in the Public Account belongs to the Government because it has to be paid back at some time or the other. In other words, appropriation can be done out of this fund without an appropriation act but the money so drawn has to be replenished by the Government from Consolidated Fund of India through an appropriate appropriation act.

The General discussion on the budget, which takes place one week after the presentation of budget, has been criticized for being more of a political nature than of financial nature and a major part of the time is used by the opposition to review the work of the Government for the year and ventilate the grievances of the people. The General discussion takes place almost simultaneously in both the Houses of the Parliament and the Finance Minister makes a general reply at the end of the discussion.

The next stage in the budgetary process is the Debate and Discussion on Demands for Grants. The Debate is, followed by voting on demands for grants. The voting on demands is the exclusive privilege of the Lok Sabha and the Rajya Sabha does not take part in it. The total number of days allotted for the voting on demands is about 16 days. The Speaker in consultation with the Leader of the House fixes a time limit for discussion on a particular demand or on a group of demands and for the entire expenditure

part of the budget and as soon as the time limit for any demand is reached, it is immediately put to vote irrespective of the fact whether the discussion on it is complete or not. At this stage, a full discussion on demands for grants takes place, item by item, department by department. Usually the annual report of the department forms the basis of the discussion on demands for grants. Various cut motions are introduced by the members. The purpose of cut motions is to initiate the discussion on the various heads of expenditure. This opportunity is used by the members generally to ventilate the grievances against the administration, of particular departments of the Government. Various cut motions introduced in the legislature are:

(i) Token Cut

As each head of the expenditure comes up for discussion, some member rises and moves a token cut of one rupee or a hundred rupees in its estimates. Then the members proceed to criticize the administration of the department to which the demand for grant relates. The proposed cut of Re.1/- or Rs.100/- does not mean that the legislators disagree with the proposed demand. It, however, conveys to the executive that the legislators disagree with the way the administration of the department is being carried out. The proposed cut hence gives them the opportunity to discuss the administration of the department.

(ii) Policy Cut

The policy cut motion is introduced by a member by stating that he disagrees with the demand for grant of the department and that it should be reduced to Re. 1/- (or Rs.100/- say) i.e. to a very small and negligible amount as compared to the demand of a few crores of rupees stated in the budget. This cut motion is called as the Policy cut motion, because the reduction of the amount demanded by the executive to just one rupee amounts to the rejection of the policy of the executive. Hence, if one rupee is granted to him, the executive will not be able to carry out the proposed policy. Hence passage of a policy cut tantamount to a vote of no confidence and the Government has to seek a fresh vote of confidence in the legislature:

(iii) Economy Cut

The economy cut motion is introduced by a member if he feels that the finances are not being managed properly by the department for which the demand for grant is being discussed. The member hence proposes the cut by stating that "Let the demand `be reduced to Rupees....." Then the member proceeds to criticize the administration of the department to which it relates.

After one of these motions is raised and the discussion on demand for grant has taken place, the Minister concerned has to defend the administration against the onslaught of the members at the end of the discussion of each demand. Before the demand for grant is to be put to vote, if the opposition members are not satisfied with the reply of the Minister, the concerned Minister often agrees to the demands of the opposition members and hence accommodate their views. Once this is done, the demand for grant is put to vote. A demand when duly voted, becomes a grant. It needs to be pointed out at this stage that the House can only reject or reduce a demand but cannot increase it. The logic behind not allowing the House to increase the demand is that the Executive cannot be held responsible for the money which he did not demand and yet the additional money was sanctioned by the House out of its choice. In future, if more money is needed for expenditure, it is authorized by way of supplementary grants or may be spent out of Contingency Fund.

D. Passing of Appropriation and Finance Bill

The next stage in the budgetary process is the passage of the Annual Appropriation Bills. All the demands voted by the Legislature and the expenditure charged on the Consolidated Fund of India are put together and incorporated in a Bill called the Annual Appropriation Bill [Art.114(i)]. However, the amount shown in the Appropriation Bill should not exceed the amount shown in the Statement previously laid before the Parliament in the form of Demand for grants. The point behind getting the Appropriation Act passed even though same amount has been granted by the Parliament when it voted on the demand for grants, is that the approval of Demands for grants by the Parliament does not empower the Executive to appropriate the money. It only, means that the Parliament approves of the policies of the Executive

which in turn does not mean that the Executive can draw the money and appropriate it also. After the bill is introduced a general debate follows in the House. The debate is restricted to those points only which have not been already discussed during the debates on estimates. The bill follows the same procedure in the House as any other Bill except that no amendments can be moved at this stage. Also, at this time no cut motions can be introduced. The appropriation bill contains details like the extent of money being sanctioned and the year for which it is sanctioned; the purpose for which it is sanctioned and the authority in whose favour it is being approved. Generally, the practice in India is to present as many appropriation bills, as there are demands for grants. Hence there are 103 Appropriation Bills dealing with civil expenditure while 6 bills are there dealing with Defence Expenditure i.e. total 109 Appropriation Bills in all. Most of the time all these bills are passed in a single day.

After being passed by the Lok Sabha, it is certified by the Speaker as a money bill and sent to the Rajya Sabha. The Rajya Sabha has neither the power of amending nor rejecting the Appropriation Bill. It can only discuss and make recommendations within 14 days to the Lok Sabha, which the Lok Sabha may or may not accept. Even if the Lower House rejects the suggestions made by the Upper House, the bill will be considered as passed by both the Houses in the form in which it was passed by the Lower House. In case the Upper House does not make any recommendations within the above specified period and remains silent, the bill will be deemed to have been passed by the Upper House on the expiry of that period. The appropriation bill is then sent to the President for his assent. It is just a formality because the President cannot return a money bill for reconsideration. The bill, after the assent of the President, becomes an Act.

The Appropriation Act authorizes the Government to appropriate money from the Consolidated Fund but it has not so far been provided where from the money for expenditure would come. For this purpose, a Finance Bill is placed before the House, in which provisions are made for collecting the required money by way of taxation. This bill, hence, incorporates the financial proposals of the Government for the ensuing year and is placed before the Parliament at the same time as the budget. The procedure followed is that of money bill and it is only in the Select Committee of Parliament" that the Bill is considered in detail and amendments

are moved. After the presentation of the Committee Report, clause by clause consideration of the bill follows. The scope of amendments is restricted to proposals for the reduction or abolition of a tax. The financial/taxation proposals become operative as soon as the budget is presented under the Provisional Collection of Taxes Act, 1931. This is done in order to avoid the large scale hoarding and cartelization practices of the traders for the period of next one month i.e. 28th February to March 31st. The Finance Bill must be passed before the end of April and after having been passed the Government is authorized to collect these taxes. With the passage of the Appropriation Bill and the Finance Bill, the enactment of the budget is complete.

The budget contains the ordinary annual estimate which constitutes the bulk of the annual receipts and charges. To meet the expenditure on circumstances unforeseen at the time of budget, there are 4 kinds of other grants which the Lok Sabha may be asked to make. These are:

- (i) Supplementary Grants
- (ii) Vote on Account
- (iii) Exceptional Grants
- (iv) Vote on Credit

(i) Supplementary Grants:

If the amount authorized by the Appropriation Act of the year is found to be insufficient or if expenditure on some new service becomes necessary in the course of time or if expenditure incurred on any service exceeds the amount provided for in the budget, the President is authorized under Article 115 of the Constitution to cause the supplementary financial statement embodying the supplementary demands for grants, to be laid before the Parliament. The supplementary grants are passed according to the usual procedure followed for the presentation and passage of the appropriation bill.

(ii) Vote on Account:

Under Article 116 of the Constitution, the Lok Sabha has power to make any grant in advance in respect of the

estimated expenditure for a part of any financial year pending the passing of the Appropriation Act. At times, it happens that the passage of the budget is delayed and is not complete by the end of the March. Since, all the money spent by the Government after March 31 would become illegal in case no appropriation act exists, the Lok Sabha makes provision for the money to be spent during the period pending the passage of the Appropriation Act through the provision of Vote on Account. The Parliament usually passes one twelfth of the whole years gross requirements, asked for in the budget, for each of the succeeding months after March 31st. Once the budget is passed, such an amount is adjusted against the amount granted in the budget. It may, however, be mentioned that the amount sanctioned under Vote on Account is to be spent on such services as have received the sanction of the Parliament and, usually it is not to be used for the new services unless specified by the Parliament.

(iii) Exceptional Grants

The Parliament can also grant money in advance for meeting emergencies during the course of the year, when the amount sanctioned in the budget is not sufficient to meet the emergency efficiently and effectively. In this case, the Government presents an estimate to the Parliament which is passed by it.

(iv) Vote on Credit

Vote on Credit is granted to the Government under Article 116 according to which the House of People has the power to make a grant for meeting an unexpected demand upon the resources of India, when on account of the magnitude of operation or the indefinite character of the service, the demand cannot be stated with details ordinarily given in an Annual Financial Statement. However, proper accounts are later to be furnished and passed by the Parliament.

Chapter – IV

Execution of the Budget

After the enactment of the budget the next step in the budgetary process is its execution. The two important principles involved in the execution of the budget are-

- (i) The budget execution must conform to the terms of the Appropriation and Finance Acts; and
- (ii) There must be a high degree of honesty, integrity and efficiency in the execution of the budget.

In other words, the successful execution of the budget is one in which all the financial rules and regulations are observed e.g. invitation of tenders for the contracts etc., and all the goals are achieved, maintaining a fine balance between administrative flexibility and the rigidity of the financial rules and regulations. What is more important at this stage is that the intent of the legislature behind the budgetary provisions is preserved along with the observation of economy while spending the money and allowing no misappropriation~ of the money. The process of execution involves following operations:

- i. Assessment and Collection of Funds.
- ii. Custody of Public Funds.
- iii. Disbursement of the Funds in the Departments.
- iv. Accounting.
- v. Auditing

Before the taxes are collected, they have to be assessed properly so that they do not cause unnecessary hardships and harassment of the individual tax payers. Assessment, therefore, involves the preparation of a list of persons liable to pay the tax and also determination of the extent of tax each of them has to pay according to the prescribed rates. The assessment of taxes in India is done by the Department of Revenue in the Finance Ministry in consultation with the Central Board of Direct Taxes (CBDT), the Central Board of Indirect Taxes (CBIT) (CBIT is also known as Central Board of Excise and Customs), and other field agencies.

The same machinery is also involved in the collection of taxes which is a very debatable issue.

The custody of funds so collected in most of the countries is entrusted to the Central Bank of the country. The Central Bank carries out all the money transactions on behalf of the Government. However, in a large country like ours, where the banking facilities are not sufficient, it is not possible to have such a centralized system for receiving money and for making payments on behalf of the Government. However, wherever a branch of Reserve Bank of India exists, there it performs the functions of the treasury. In case, where the branch of RBI does not exist, the treasury functions are carried out by the State Bank of India (SBI). In a district where there is no SBI or RBI branch, or for historical reasons, a District Treasury exists, there it performs the functions of custody of funds. The Government of India maintains about 300 district treasuries and 1200 sub treasuries to ensure safe custody of funds.

Disbursement of the funds is the process of withdrawal of money from the treasury for the payments of various liabilities. The legislature makes the grants to the Government as a whole technically to the President and not to the individual departments. The Ministry of Finance designates the head of each administrative department as the controlling officer in respect of the expenditure occurring in the department. After the passage of the budget, intimation is sent to the Head of the Department from the Ministry of Finance, listing the amount sanctioned for various quarters in the year. Heads of the Departments distribute, these funds to the disbursing authorities i.e. DDO (Drawing and Disbursing Officer) in the departments. DDO is the person who is authorized by the various administrative departments to draw cash from the treasuries and distribute it in the department according to the budget sanctioned. The accounts of the money so withdrawn by the DDO are kept by both the officers i.e. DDO and the Officer in charge of the Treasury. The treasury officer compiles these accounts on a monthly basis and sends them to the Accountant General. On the other hand, a quarterly review of the accounts maintained by DDO is done by the Head of the Department. The quarterly review of the account is also done by the Ministry of Finance before releasing the amount for the next quarter. The quarterly review of the accounts in the Ministry helps the Ministry to prepare the revised estimates which are to be presented in the next year's budget as the revised "estimates of the current year.

Although, at the time of budget execution, the Executive is empowered to change the destination of a particular grant from one minor head to another minor head, the Executive authority to allow for such changes in destination is vested in the officials of the Ministry of Finance i.e. any change of appropriation from one minor head to another minor head requires the concurrence of Ministry of Finance.

Chapter V

Taxation

A. Meaning

Tax is a major source of income of the Government. Now in the democratic set-up it has been accepted that a Government can not run its administration without imposing as-well-as collecting tax.

In the medieval age no proper attention was given by the administration and no proper attention was given by the economists to the tax. They believed in fringe taxation and the least possible taxation was their maxim. Every additional tax was hated by the thinkers. But with the fall of the individualistic ideology, tax has acquired a predominant role in the public revenue. A better taxation system speaks of the better taxing capacity and efficient economic administration of the Governments.

A tax has a multi-dimensional effect and it affects every section of the community in one way or the other. If imposed on producers, it restricts the producing capacity and if imposed on commodity, it affects the demand of the commodity and in similar way if imposed on the income of the individuals, it restricts their monetary purchasing power. A tax may encourage and if it is excessive, may discourage the economic development and production. By doing so, it may reduce the public welfare. However, there are varied problems regarding the levying of a tax.

B. How to levy Taxes

Various principles have been formulated by experts, but none of them have given exact canons. However, all of the canons given by the experts from time-to-time throw some light on the various aspects of a good taxation policy.

Adam Smith was the first to give a detailed theory of taxation. According to him if the principle enumerated by him was fully adopted, the Government would have a very good taxation policy. Commenting on the contribution of **Adam Smith**, **Findlay Shirras** writes: *No genius however, has succeeded in condensing the*

principles into such clear and simple canons as has Adam Smith.'

Canons of Taxation

Adam Smith has given following canons of taxation:

- (i) Canon of Equality
- (ii) Canon of Certainty.
- (iii) Canon of Economy.
- (iv) Canon of Convenience or Ease.
- (v) Canon of Productivity.
- (vi) Canon of Flexibility.
- (vii) Canon of Simplicity.
- (viii) Canon of Expediency

(i) *Canon of Equality*

According to this principle the burden of taxation should be distributed in such a way as every citizen's share is equal to the others. An equal amount of sacrifice should be acquired from every citizen. No tax should be levied which is against equality. Thus in this principle it is maintained that the tax must be levied according to tax – paying capacity of the individuals. To quote **Adam Smith**, *'The subject of every State ought to contribute towards the support of the Government as – nearly-as possible in promotion to their respective abilities; that is in promotion to the revenue which they respectively enjoy under the protection of the State.'*

Thus rich people must be subjected to higher taxation in comparison to the poor. Higher the income, higher the tax and lower the income, lower the tax.

(ii) *Canon of Certainty*

Adam Smith has explained this principle as: *'The tax which each individual is bound to pay ought to be certain not arbitrary. Thus time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every person.'*

This principle requires that following aspects of particular

type of tax must be predetermined:

- a. Amount of tax to be paid.
- b. The place of payment.
- c. The authority to which the tax is to be paid.
- d. The time of payment.
- e. Procedural information regarding payment.

This will enable the tax-payer to keep equilibrium between his income and expenditure. No arbitrary or undecided precedent should be followed by the Government authorities, while levying or assessing a particular type of tax.

Uncertainty in the field of taxation is very dangerous to the individual and economic development. According to **Hadley**: *Certainty is the fundamentally important object without which all attempts at equality prove illusory.*'

(iii) Canon of Economy

Minimum possible money should be spent in the collection of taxes. The whole process should be handled in such a way that a large portion of the tax is not spent by the exchequer to meet only the collection charges. If a taxation policy is costly to manage, it is no longer a good taxation policy. But it does not mean that efficient and strict management should be kept out of place.

In the words of **Adam Smith**, *'Every tax ought to do so contrived as both to take out of the pockets of the people as little-as possible over and above what it brings into the public treasury of the State.'*

(iv) Canon of Convenience

A good taxation policy must be convenient to the tax-payer. The time of assessment should be as to facilitate tax-payer in paying his taxes. It should not be at *'Odd'* times or at *'Cold'* times from the business point of view. Assessment times and payment periods should be at the ease of the tax-payer. A complicated method of paying the tax should also be avoided.

(v) ***Canon of Productivity***

Prof. Bastable founded this canon and opined that '*the principle of taxation must be based on the productive lines. Taxation must be to accumulate enough money for the Government to run its administration efficiently. It must be enough to enable the Government to secure enough facilities for the people.*

A taxation on productive lines must be dynamic. It must be based on the earnings and mobility of money and income in future. This implies that a details study should be undertaken to avoid any kind of evil influences of taxation on the various sections of the community. No tax should discourage the production capacity of the individuals. Since the productivity of taxation depends upon individual productivity. Unfavourable tax may reduce the working efficiency, which will in consequences reduce the tax-paying capacity of the individuals.

(vi) ***Canon of Flexibility***

Elasticity or flexibility refers to the respective contraction and expansion of the taxes to the requirements of Government from time-to-time. Taxation should be as such to increase according to the increasing needs of the Government. It must have the capacity to expand as per requirements of the Government. It also must have the capacity to contract, if Government demand for money is reduced to balance the income and expenditure. Today income-tax is considered to be the most elastic tax as it can be increased according to the expediency.

(vii) ***Canon of Diversity***

This principle requires that burden of the tax should be scattered among different kinds of the people and under different subjects and headings. The burden of paying the tax should not centralize on one group of the people. Diversification should be in such a way as every section and every individual must pay something to the National Exchequer. Every person must be obliged to pay according

to his capacity. This is why, it is maintained that the best system of taxation is that system in which there is proper mixture of direct and indirect taxes. In such a system every individual becomes the tax – payer.

(viii) *Canon of Simplicity*

This principle requires the procedural easiness to the tax-payer. The procedure must be very much clear and easily understood by the tax-payers. If a common man is able to understand this policy then it is good, otherwise not fruitful. A complicated system may bring various types of irregularities, which are harmful to the tax-payers as-well-as the Government. A complex system is unjust and uneconomic.

(ix) *Canon of Expediency*

It should be imposed in such a way that Government must have just assertions to support the imposition of a particular type of tax. Because a tax without any expedient cause will face criticism from the tax-payers. It would be unjust and may face defiance from the tax-payers. Every tax requires its justification to create desirability in the tax-payers. Such precautions must be taken while levying such tax, which received opposition from the tax-payers.

Conclusion:

These principles are considered to be the essential requirements of a good taxation policy. But it is far difficult to create all the qualities in a taxation policy.

C. Proportional Taxes

Meaning:

Proportional tax may be defined as the tax which is levied in proportion to the income and property. Its amount increases with the increase in income and property and decreases with the decreases in income and property.

Characteristics of Proportional Taxes:

Proportional tax has following characteristics:

- (a) It is proportionately changing and its proportion changes with change in income and property.
- (b) It is fixed percentage, but varying amount.

Proportional tax can be explained with the help of the following schedule:

Income (In Rs)	Amount of Tax (In Rs)	Tax (In %)
100	7	7
200	14 (7 x 2)	7
400	28 (7 x 4)	7
500	35 (7 x 5)	7

In short, when it is said that 7% of the income and property is to be paid as tax, it is called a proportional tax. In proportional tax rates, the rates of taxation remain constant with the changing tax base. The amount to be paid as tax can be assessed by multiplying the tax base with the rate of tax payable. Following diagram explains the concept of proportional tax-rates:



Figure

Here the line AB moves horizontally, while the tax rate (OA) remains constant throughout, without being affected by the tax base. The concept of progressive taxation is based on following assumptions:

- (a) The distribution of income in the economy is just.
- (b) Tax should not alter the proportion of difference of income of the different tax – payers.

Merits of Proportional Tax System:

Following are the merits of Proportional Tax System:

- (1) It is easy for every individual to evaluate the amount of tax.
- (2) It does not affect the pattern of the distribution of income in the society.

Demerits of Proportional Tax System:

Main disadvantages of Proportional Tax System are:

- (1) It is not just since it does not provide relief to the people belonging to low-income group.
- (2) It does not go parallel to the principle of taxable capacity.
- (3) It contributes less to the public Exchequer.

D. Progressive Taxes

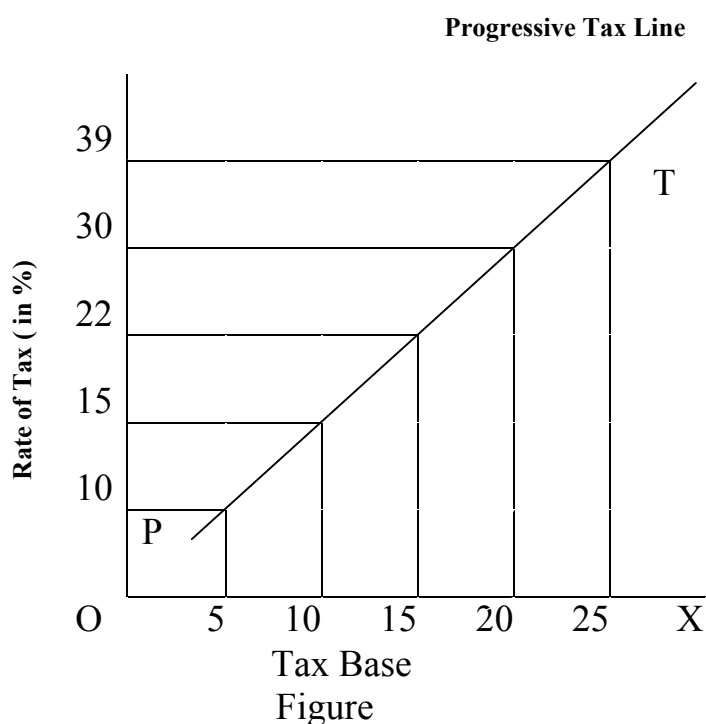
Meaning:

Progressive tax is the tax which varies with the change in income of the different individuals. The rate of tax is gradually higher for the increasing incomes and lower for the decreasing incomes. It does not provide for a fixed and uniform percentage for all the income groups like the proportional tax system.

Following schedule will explain the progressive tax:

Income –Group (Taxable)	Rate of Tax (in per cent)
0-5000	10
5001-10,000	15
10,001-15,000	22
15,001-20,000	30
20,001-25,000	39

Following diagram will be helpful in understanding the progressive taxes:



Here with the increase in the income (shown on x – axis) there is gradual increase in the percentage of tax (shown on y – axis), *i.e.* Line PT, Progressive Tax line shows a upward trend with every increase in the income. Thus, higher the level of income, higher the percentage of tax and lower the level of income, lower the percentage of tax.

Merits of Progressive Taxes:

Main advantages of Progressive Taxes are as under:

(i) Progressive Taxes are always according to the Principle of Equality:

Any increase in the income of individual reduces his utility from the marginal units of money. In other words, law of diminishing marginal utility applies on the monetary income. The rich gets less utility from additional units of money in comparison to the poor. Thus rich should be taxed more than the poor to create equality. This can be done by using the rate of progressive taxation only.

(ii) Progressive Taxes are more just:

This tax is 'just' in the sense that it puts more burden of tax on the rich and less burden on the poor. Thus, it serves the purpose of morality in taxation. It gives relief to the poor.

(iii) Progressive Taxes help progressive distribution of income:

This quality of progressive taxes gives it commendable place in the modern techniques of taxation. Modern society is full of inequality of incomes. For a stable and just society it is essential to narrow the gap between the different kinds of individuals. Progressive taxes are highly helpful in curing this disease of unequal distribution of income.

(iv) Progressive Taxes are more flexible:

A good tax system must have the quality of elasticity. It must be changeable according to the need. Progressive taxes provide enough facility to the Governments in increasing their revenues on the eve of necessities of great importance like war, famines, and drought etc.

(v) More Economic:

Progressive taxes can be easily collected. Government need not spend a lot of money in the collection of progressive taxes.

Demerits of Progressive Taxes:

Disadvantages of Progressive Taxes are given below:

- (i) It is very difficult to determine the progressive amount of taxes. The rate of increase with the increase in income cannot be easily determined. Any determination may not always be just.
- (ii) This kind of tax supports the theory of socialism. It is bitterly opposed by the producer's class.

- (iii) Progressive taxes discourage the entrepreneurs. It also discourages those who want to increase their earnings through higher production.
- (iv) It adversely affects the propensity to save. It dims the chances of high level of investment.
- (v) It injects a feeling of tax-evasion in the mind of those, who are rich and are subject to high taxation.

Inspite of those criticisms and drawbacks the progressive taxation has been widely acclaimed, supported and adopted.

E. Deficit Financing

Meaning

It is a deliberate excess of expenditure over income, when carried out by Governments, and is also known as corporatory finance or pump priming. Such deficit finally takes the form of a budgeted deficit financed by borrowing. It has the object of stimulating economic activity and employment by injecting more purchasing power into the economy. In fact, with the growth of Government expenditure, budget deficits are more common even in times of full employment so that the deficit financing in the true sense would normally consist of increasing the deficit as a matter of policy. The use of deficit financing as a part of monetary policy was first advocated by **J.M. Keynes** in his *Quantity Theory of Money*.

Techniques of Deficit Financing

A Government has three important techniques at its disposal to finance its budgetary deficits:

(i) Borrowing from Central Bank

Meaning thereby restoring to creation of new money.

(ii) The Use of Accumulated Cash Balances

Meaning thereby withdrawal of cash balances by the Government from the Central Bank (Reserve Bank of India

in case of India) to finance budgetary deficits or for increasing the supply of money.

(iii) The Issue New Currency

One thing common to all the above methods is that all these methods lead to increase in the supply of money. It has been rightly pointed out that the '*deficit financing by Government for filling up the gap in its investment budget would result mainly in an outright expansion of currency.*'

Objectives or Goals of Deficit Financing

Following are the main objectives of deficit financing:

(i) To negate the effect of depression:

It has been resorted to in industrially advanced countries to negate the effects of depression.

(ii) To finance wars

It has been resorted to finance part of the costs of wars.

(iii) To mobilize resource

It has been resorted to in recent years to mobilize resources for promoting rapid economic growth in under-developed countries.

Advantages (Merits) of Deficit Financing

(i) Price level

Deficit financing causes an increase in the gross expenditure of the society. Since there is an increase in total expenditure in the economy, the price level goes up. When considered in the Indian context as a result of the additional purchasing power acquired by the people through Government spending of the deficit induced created money, the price level starts showing upward trend.

(ii) Depression and Deficit Financing

The theory of **Lord J.M. Keynes** has motivated to use the public expenditure as a balancing factor to make up for the deficiency in private demand. One of the characteristics of depression is fall in effective total demand and this fall is accentuated by falling employment. This vicious spiral of deficiency in demand, can be met, and the vicious spiral broken, only through public expenditure *i.e.* by embarking upon public works projects, which will in turn create employment and increases the purchasing power in the hands of the people and will lead to increased demand for goods; thus necessitating increased production; and this brings employment and this leads to a still further increase in demand. This is how the Government expenditure acts as a balancing factor in restoring national income, total demand and employment at a high level. But public expenditure can be fruitful in this aim only, when financed by means of a deficit, so that the additional money may increase the total spendable funds and thereby cause increase in total demand and employment in the country. Economists are of the opinion that deficit spending of this type does not have inflationary effects, because the fall in employment and economic activity in industrially advanced countries during depression is a temporary phase and though there is a fall in productive activity, yet the productive capacity of the economy remains more or less intact. Thus when as a result of deficit spending, more purchasing power is created into the economy and demand increases, the temporarily idle resources, come in use again and production increases.

This establishes the utility of deficit financing is an effective weapon to fight the depression.

(iii) War Expenditure and Deficit Financing

When a country faces war, the urgent attention is to mobilize resources for the war and for this, besides the normal methods of getting resources, State may resort to deficit financing. It curtails other uses of various goods through a rise in prices and enables their diversion for war purpose. The price increase occurs owing to the fact that on the one

hand increased purchasing power is thrown into the economy through war purchases and on the other hand the resources are used not for increasing the production, with the result there is a fall in the availability of goods. In other words, deficit financing during war leads to inflationary pressures on the national economy.

(iv) Level of Employment and Deficit Financing

Lord J.M. Keynes had stated that level of employment depends upon the effective demand. In other words, conditions of unemployment may be removed by increasing the effective demand. This aspect of deficit financing can have different impacts on developed and developing economies.

Developed Economies

To increase the effective demand and remove the state of unemployment in developed economies (may be recession or depression) **Keynes** advocated deficit financing to finance public works projects so as to increase the purchasing power in the hands of the public and thereby increase the effective demand and hence the employment; again increase effective demand and, hence employment and this chain reaction will go on. **Keynes** called it '*multiple effects*'. Thus the deficit financing when used during the period of depression, not only the tendency of decreasing demand is not only checked, but the cycle of increasing effective demand is placed in motion, thereby leading to increase in the employment and level of income in the developed economics.

Developing Economics

The techniques of deficit financing is helpless in removing the conditions of unemployment in under – developed economics, since in such economies there is absence of idle and unutilized capacity in industrial and agricultural sectors. This is further aggravated by the lack of capital formation and existing capital equipment. It is also the fact that multiple concept does not hold good in under-developed countries due to the lack of entrepreneurship, lack of technical knowledge, lack of *infra-structure* or economic

and social overheads and market imperfections. The role of the multiplier principle is to raise the effective demand rather than effective supply. But, the problem of under-developed countries is of increasing the effective supply rather than effective demand, therefore, multiplier principle is not of any help to under – developed economies and thus no help is rendered by the technique of deficit financing in such economies.

(v) Deficit financing and Economic Development

It is often suggested that the technique of deficit financing may be used in a developing economy to mobilize resources for economic growth through forcing the people to save to a larger extent than it otherwise would and by diverting the saved resources into investment. In developing economics having low per capita income huge public investment has to be undertaken and for this taxation and other revenue receipts along with borrowing may not be enough to provide adequate funds for this purpose. Thus, resources may have to be taken through deficit financing, so that with the help of this additional purchasing power the Government may obtain resources and channellize them into investment. The process of diversion of resources from private to Government uses is assisted by the fact that the increase in prices following deficit financing restricts private demand for goods. In this way the technique of deficit financing may lead to forced saving and use in the general level of investment in the economy.

Demerits / Disadvantages of Deficit Financing

Demerits of deficit financing can be studied as under:

- (i) Deficit financing causes inflationary pressures and this problem is further accentuated by the fact that, because of the low standards of living of the majority of the people, the additional purchasing power injected in the economy tends to be spent rather than saved, thus adding to the total purchasing power.
- (ii) Public expenditure caused by deficit financing increases demand but in the absence of idle capacity in poor economies, the increase in purchasing power as a result of

deficit financing does not lead to an increase in output.

- (iii) Developing economies have a rigid productive structure and thus output cannot be rapidly increased. Besides, it often happens that a great part of investment expenditure in poor economies is on projects which have long 'gestation' periods.
- (iv) In developing economies imports of consumption goods cannot be increased because of balance of payments constraints and thus the position worsens when deficit financing is resorted to and there arise inflationary trends.
- (v) In an under-developed country, inflation affects adversely and in more than one way *i.e.* it causes great hardship and misery to certain sections of the society, dislocates the economy and monetizes the steps taken for economic growth, causes fall in value of money which checks savings and thus nullifies the purpose for which deficit financing is resorted to.
- (vi) The rise in prices caused by deficit financing reduces the confidence of the people in the stability of the economy.

It may be pointed out here that extent to which deficit financing is resorted to is also important because at any given time the economy can cope with a certain amount of deficit financing beyond which inflationary forces operate. *'However, there is no precise method of knowing in advance the safe limit of deficit financing, partly because the economic situation is subjected to continuous change. Hence, even after the best estimate of deficit financing that can be made, the situation has to be kept constantly under watch and steps have to be taken if there are indication of the rise of inflationary pressures.'*

Thus it may be concluded that the deficit financing for economic growth can be inflationary, but is not necessarily always so and the question whether it will lead to inflationary pressures depends on the purpose for which it is undertaken, its extent and the measures which are undertaken to counteract it. It thus may be said that deficit financing can play an important role in the mobilization of resources or economic growth if it is taken care that it does not lead to inflationary pressures. Thus while resorting to deficit financing

greatest care should be taken to ensure that it does not give rise to inflation and suitable preventive and corrective measures should be adopted to cope with any such eventuality.

Chapter – VI

Control over Public Expenditure

Control of Public Expenditure takes various forms in India and in other countries of the world. The control over the public expenditure i.e. the budget can be discussed under the following three heads:

- A. Executive Control over Expenditure,
- B. Legislative control over the Expenditure, and
- C. Control over Public Expenditure through independent agencies.

A. Executive Control over Expenditure

Executive control over expenditure extends right from the stage of budget formulation to the last stage in budget execution. This control is in the following forms:

- (i) Role of Finance Ministry in budget formulation and execution.
 - (ii) Accounting of expenditure.
- (i) ***Role of Finance Ministry in the Budgetary Process:***

The Ministry of Finance is the nodal ministry for the purpose of executing the budget as well as formulation of the budget. The Finance Ministry enjoys an enviable position in the administrative set up of the nation. Most of the administrative decisions taken by the various ministries have financial implications i.e. either they seek to make expenditure or they seek to contribute revenue to the finances of the nation. Hence, while taking all these decisions, either a consultation or a clearance from the Finance Ministry, which is the nodal ministry, is required. The role Finance Ministry can be as under:

- a) The Finance Ministry has a near discretionary say in the policy affairs of the nation, since the finances for the execution of all the policies are to be provided by the Finance Ministry.

- b) Formulation of the budget is the prime responsibility of the Finance Ministry. After the budget is formulated it is presented to the Cabinet for its consideration and thereafter it is presented to the Legislature by the Finance Minister for legislative sanction.
- c) The Finance Ministry through its powers of controlling the finances actually controls and coordinates the work between the various ministries.
- d) The Finance Ministry is also responsible for the effective utilization of foreign exchange resources and also to take care of currency and coinage related affairs.
- e) The Finance Ministry also guides the banking and monetary policies of the nation, though it does not have any direct control over them. However, through banking and monetary policies, the entire financial discipline of the country is maintained by it.

The Controlling role of Finance Ministry can be divided into two distinct stages:

a) *Pre-Budgetary Control*

The Pre-Budgetary Control of the Finance Ministry starts at the time when proposals are sent to it for inclusion in the budget estimates. It scrutinizes the proposals from technical, policy and financial, view points before giving its approval. The approval of the Finance Ministry can also be either of the three types of approvals or a combination of the three types namely Technical, Approval, Financial Approval, Policy Approval. Even if only one out of three (3) approvals is not accorded, the project cannot be included in the budget. Finance Ministry insists at this stage that any demand for grant for fresh projects shall be accompanied by proper documents and an analysis of the associated costs and benefits. Any fresh demand for grants that does not have any documentary support with it justifying the money asked for, its inclusion in

the budget can be summarily rejected by the Ministry and it is not included in the budget estimates. The task of consolidation of the estimates after their department wise classification is done by the Finance Ministry so that it can be presented to the Cabinet. At this time, if individual departments want to get the amount asked for in the budget under a specific head or sub head increased they have to approach the Budget Department of Finance Ministry to get the amount increased by satisfying the officials of the budget department that the increase in the estimates as demanded by them is justified. However, if they want to get the amount asked for under a particular head decreased, then they have to merely inform the Accountant General, who in turn informs the Finance Ministry about it and the decreased amount is entered in the budget. Thus, the Finance Ministry keeps a close watch on the estimates of various ministries and it can effect coordination by sanctioning finances only at the time when it is desirable and it also avoids duplication of work by stopping the finances.

b) *Post-Budgetary Control*

The Finance Ministry controls the financial transactions of the departments even more closely after the budget has been passed and is being executed. The Finance Ministry again examines the whole demand afresh when the department approaches the Ministry for the release of the money for the next quarter. At this stage, often in the changed scenario, some of the demands become redundant and hence are eliminated. The Finance Ministry to keep a close watch on the expenditure pattern of the respective departments and to maintain financial equilibrium within the country releases the money to the departments in quarterly installments. The Ministry does not release the money for the next quarter unless the account for the previous quarter is furnished by the department. This keeps a check on the departments, as they cannot hide a misappropriation of the money and the misappropriation, if any, is detected right at that time when it is done. Often for the purpose of keeping

accounts in the department, and to perform internal audit of the departments integrated Finance Officers are appointed in the departments. The IFO at the time of preparation of budget estimates advises the departmental authorities about the documental support that should be given to a particular budget estimate. He also examines the estimates from the point of view of policy and financial approval (not the technical approval) and gives his advice to the department. At the time of budget execution, he checks the accounts prepared in the department and in a way acts as the internal auditor. The IFOs are hence an instrument through which the Ministry of Finance regulates expenditure as IFOs work in *close cooperation with the Ministry and are appointed by it.*

(ii) *Accounting in India*

Generally speaking, accounting is an executive function and is therefore usually, vested in the executive departments of the Government. But in India, accounting has not been made the responsibility of the executive. It is vested in a separate department known as the Accounts and Audit Department headed by the Comptroller and Auditor General of India (C&AG), whose office is a creation of the Constitution. There is in each State an Accountant-General in whose office the accounts of the transactions (of the Union as well as State concerned) taking place within the territorial limits of that State are maintained. It is worth noting that the A.G.s office (Accountant General) does not maintain the accounts of the Railway and Defence departments: These are maintained by the Financial Commissioner for Railways and the Military Accountant General respectively. The various stages in accounting in India are as follows:

- a) The initial entry relating to the expenditure incurred by the department is kept by the Treasury Officer, who is incharge of the Government Treasury (The Government Treasury is maintained at the cost of the State Government, but it keeps the accounts of the Central as well as State Governments) and the departmental officer designated to perform the accounting function. The Treasury Officer sends a list

of payments made during these intervals, supported by vouchers to the A.G.

- b) The classification of the accounts is then done by the A.G. according to the head of the account. There are four different accounts, i.e. revenue accounts, capital accounts, debt accounts and remittances. Each of these accounts is further sub divided into major heads, minor heads which are in turn further divided into detailed heads.
- c) The next stage in accounting is compilation of accounts. However, before compilation, the accounts are audited by the auditor. The compilation of the accounts is done every month in the department, once in 3 months by the Finance Ministry and on yearly basis by the CAG.
- d) Lastly comes the annual compilation of all the accounts by the Auditor General of India. He submits the Finance Accounts, Appropriation Accounts and his Audit Reports to the President (or the Governor, as the case may be).

B. Legislative Control over the Expenditure

The control of the legislature over the budget follows a very old principle "No taxation without representation". The control over the finance has hence been provided to the representatives of the people due to the fact that all the activities of administration can be controlled by having a control over the finance. The control of the legislators hence provides an opportunity to the MPs to criticize the Government and hence expose its misdeeds and instances of mismanagement of financial affairs by the Government. The legislative control over the budget is exercised through the following instruments:

- a. General discussion on the budget.
- b. Cut Motions followed by Debate and voting on demand for grants.
- c. Passage of Finance bills and Appropriation Bills.
- d. Committees of the Parliament dealing with Financial

Affairs i.e Estimates Committees, Public Accounts Committee and Committee on Public Undertakings and also the newly constituted Department Related Standing Committees.

- e. Control over other money and finance bills (other than the budget) in the form of debates, discussions and the power to pass these bills.

Points (i) to (iii) have been covered in detail in the chapter on budget, here we shall discuss about the committees of the parliament in detail:

➤ **The Committees of The Parliament**

The Committee System in the Parliament is adopted in order to overcome the deficiencies of the control of the Parliament. The Committees are formed based on the system of proportional representation and are representative of the whole House. The strength of the committees is small, usually less than 30 members in India. The Committees hence being small in size, can physically move and travel to any part of the country to physically inspect the documents in a Parliamentary System. The civil servants have been provided immunity and hence they (i.e. civil servants) cannot be examined and cross examined on the floor of the House. However, the civil servants can be summoned by these committees to be present as witness in the committee meetings and they can be cross examined by the committee members to bring about the true picture relating to an issue. This provision is a very effective instrument of control on administration as the civil servants have been found to be expressing fear whenever they have been summoned by any of these committees for examination and cross examination. Another advantage of the Committee System is that committees being small bodies can undertake fruitful discussions and no formal time limits need to be observed during the meetings of the committees. Due to its small size, the Committee can become an expert body, if the members of it keep functioning in the related areas for a long time. Alternatively, various political parties can pick and choose experts among them for the membership of such committees and hence the resultant committee may be turned into an expert body, and an expert body can exercise effective

control on behalf of the Parliament.

There are three committees of the Parliament exercising control on behalf of the Parliament. These are - Estimates Committee, Public Accounts Committee and Committee on Public Undertakings.

Note: - *An exception to this is the Committee on ways and Means and the Committee on Supply of the British Parliament where the entire House of Commons has been provided the membership of both of these Committees, and hence they are quite large committees.*

i. Estimates Committee

Estimates Committee exercises pre-budgetary control. It consists of 30 members, all of whom are drawn from the Lok Sabha. The reason for restricting the membership to the members of the Lok Sabha only is that the Budget is presented to the Lok Sabha only (and not to the Rajya Sabha). Hence it is the privilege of the Lok Sabha Members to check the estimates before they are passed by the Lok Sabha. The Estimates Committee examines the Part II B of the budget in detail i.e. the portion in which the estimates for the fresh facilities to be created by the Government are given.

The Committee examines the budget estimates given in the budget to check whether estimates that have been arrived at are correct or not. Faults, if any, in the estimates are detected and are pointed out in the report of the committee. The Committee also examines the estimates from the point of view of the policy behind the expenditure that is proposed and the report of, the committee also includes a few words about the desirability of the policy also. The committee also sees to it that the economy and efficiency in the utilization is observed at the time of execution of the budget. Hence the committee also gives recommendations that should be observed next time in order to bring economy and efficiency in the administration. The idea behind the whole process of checking the estimates by the Estimates Committee

before the budget is passed by the Parliament is that something that has gone wrong in the past should be prevented from happening in the future.

The term of the Committee is generally one year but practically the term of the committee is extended beyond one year period due to the fact that the committee members can seek re-election and hence as a convention, the team of the committee is co-terminus with the life of Lok Sabha. The Chairman of the Committee is nominated by the Speaker from among the MPs in the Committee belonging to the ruling party. In case the Deputy Speaker of the Lok Sabha happens to be the member of the Estimates Committee, he becomes the ipso facto Chairman of the Committee.

The functioning of the Estimates Committee so far has suggested that the Committee has control practically on all the aspects of the Government since it can look into the policy behind a particular expenditure proposed by any of the Government department. It is hence the most effective committee out of all the Committees. However, there is one deficiency in the functioning of the Estimates Committee. Theoretically, the Estimates Committee should check the estimates before the budget is finally passed by the Legislature. However, due to the certain practical difficulties, the committee completes its examination of the departmental estimates after the Parliament has passed the budget. Nevertheless, a checking of the estimates is an effective instrument of control, even if it is done after the budget has been passed because the fear that somebody will be checking the estimates and any foul play may be detected acts as an effective deterrent and because of this gross errors in the estimates are not made by the executive in the first place.

ii. Public Accounts Committee

The Public Accounts Committee consists of 22 members of which 15 are drawn from the Lok Sabha

and 7 from the Rajya Sabha (Council of States). The membership of the Committee has been extended to both the Houses for the simple reason that although the budget is presented to the Lok Sabha, it is finally passed by both the Houses separately. Moreover, the strength of Lok Sabha is twice the strength of Rajya Sabha, hence 15 seats in the Committee have been given to the Lok Sabha MPs and 7 to the Rajya Sabha MPs. The membership of the committee is based on the proportional representation system and the term of the members is one year which however is extended to be co-terminus with the life of the Lok Sabha because of the convention that the same members get re-elected year after year.

The Committee exercises post budgetary control i.e. after the expenditure has been done as sanctioned under the budget. The Committee examines –

- whether the money was spent under the proper head;
- whether it was legally available to the person who spent it
- whether it was spent with due economy, wisdom and efficiency; and
- whether all the rules and regulations, as laid down by the Government relating to the financial administration were observed while spending the money or not e.g. whether tenders were invited at the time of allotment of the project or not; whether proper accounts, supported with vouchers, receipts etc., were maintained or not.

It is quite clear from the nature of questions that have been stated above, that the job of the committee is of a highly technical nature and hence the committee in its job is assisted by a constitutional officer called the Comptroller and Auditor General. The framework of the functioning is hence provided by the report of the Comptroller and Auditor General (C&AG). The Committee considers the audit report of the accounts of the Union Government that has been prepared by

the C&AG and based on this report, the Committee selects important issues for discussion and then examines and cross examines the witnesses and finally gives its recommendations in its report. The report of the Public Accounts Committee is tabled in the Parliament along with the Action Taken Report (ATR) of the Government.

iii. Committee on Public Undertaking

In the Industrial Policy of 1956, the Government created Public Sector Undertakings. With the passage of time, it became difficult for the Public Accounts Committee (PAC) and the Estimates Committee (EC) to exercise control on behalf of the Legislature, due to the increase in the numbers of Public Sector Undertakings. Hence, in 1964, a separate committee was created named as Committee on Public Undertakings (CoPU) and the job of keeping the control over the PSUs was transferred to CoPU. The membership of CoPU was initially fixed at 15 which consisted of 10 members drawn from the Lok Sabha and 5 members drawn from the Rajya Sabha and with the increase of the volume of work, the strength of the committee was increased to 22. Currently the Committee consists of 15 members drawn from the Lok Sabha and 7 members drawn from the Rajya Sabha. The membership of the Committee is based on the system of proportional representation. The functions of the CoPU include basically the functioning of the PSUs with a view to find out whether the functioning of the PSUs can be improved or not. The Committee reviews the profits and losses of the PSUs and gives its recommendations as to how to increase the profits of a particular PSU and how to increase their efficiency. The difference between the PAC, the EC and the CoPU is that the CoPU does not deal with the governments and deals with the Public Sector Units only.

Functioning of these Committees

Each of these Committees has a secretariat attached to it for the purpose of aiding these committees in secretarial work. The secretarial support provided to them is however of very limited nature and no expert support is provided. The Committees divide themselves in sub committees dealing with specialized subjects, so that more and more number of activities and fields of interest can be covered. However, the matters which are more important are discussed by the full committee and thereafter, if the need is felt, the matter is referred to a sub-committee for elaborate consideration. The sub-committees send questionnaires to the departments and ask for the necessary information, records etc. and then examine and cross-examine the available witnesses. The civil servants concerned with the matter can also be called to attend the meeting or to be present as witnesses. After due deliberations and examination of the matter, a report is prepared by the subcommittee which is then discussed by the whole committee and a final report of the committee is prepared. The members who do not agree with the report may attach their dissenting notes with the report. The Final Report consists of a critical examination of the functioning of these departments so far and some suggestion (or recommendations) to improve the functioning of these departments. These recommendations are not binding on the government. The Government examines those recommendations in detail and decides about what action should be taken on it. The Government has to table its Action Taken Report (ATR) along with the report of the committee in the concerned House. The Action taken by the Government may be either of these three i.e.

- i) Recommendations Accepted
- ii) Recommendations Not Accepted
- iii) Recommendations Under Consideration

The Committee now can go again into the recommendations that have been rejected by the Government and examines to find out whether the committee could be satisfied with the reasons advanced by the Government for its non-acceptance or not. If the committee is satisfied with the reasoning of the Government then that is the end of the recommendations. If

the Committee is not satisfied with the government reply the Committee gives its fresh recommendations which are to be reconsidered by the Government.

Assessment of the Functioning of these Committees

These committees have been very successful in exercising control on the financial affairs of the Government on behalf of the Parliament. The provision for submitting Action Taken Reports makes it obligatory for the government to intimate to the Committee as to what action is being taken to correct the financial mismanagement pointed out by the committee. The committee also makes the civil servants answerable for their misdeeds by calling them before the committee which cannot be done by the Legislature in the Parliamentary set up. At the same time, although the recommendations of the Committee are not binding on the Government, the Government has to consider these recommendations and often these are accepted since they carry behind them the weight of being recommended by a specialist body. However, in the functioning of the committees so far there are some shortcomings. These are as follows:

- i) It has been observed that when it comes to taking action on the recommendations, the Government often resorts to putting the note of "Under Consideration" against recommendations in the ATR. In fact the largest number of recommendations is put in the category "Under Consideration", while the least number of them are accepted by the Government.
- ii) Moreover, the Government takes very long time before it takes any action on the recommendation and then when it furnishes the ATR, it puts most of them in the category "Under Consideration". Very often, the fate of the recommendations classified as being under consideration, is not known for years altogether. In other words the committees have no follow-up mechanism to ensure that the recommendations that were accepted were actually implemented and that whether the recommendation put in the category Under Consideration was later on accepted or rejected.

- iii) Committees have no independent source of information and hence depend on the information provided by the Government, Central Secretariat and the Civil Servants. The Committee can hence only check the reliability of the information and not the completeness of the information. In the absence of complete information, the Committee may be groping in the dark to fix the responsibility. At the same time the Committee can try the civil servants for providing unreliable information under the provisions of the rules of contempt of Parliament but nothing can be done if a civil servant provides the committee with only partial information in order to save his skin.
- iv) These committees are provided with only clerical support which is in the form of attachment of secretarial staff with them. There is no professional support provided to them, except for Public Accounts Committee which has CAG to assist them. Since most of the members of the Committees are themselves amateurs, they can be outsmarted easily by the Government which enjoys the support of large professional staff. This is often evident from the fact that the Government often is found to be reluctant when it comes to providing information to these committees and the Government often refuses to supply information citing the provisions of the official secrets Act.
- v) Most of the activities of these committees are in the nature of a post-mortem. As a result the committees cannot control instances of mal-administration at the time when they are about to take place. They can control them in a manner in which their future occurrence only can be avoided.

**C. Control over public expenditure through independent Agencies
i.e. System of Audit**

The third agency that performs control over the financial expenditure, but is independent of the both i.e. Legislature and the Executive, is provided in almost all the financial administration systems across the world. This third agency is the agency that performs audit. Audit is one of the most important instruments of control over the finances of the country. It is a means of enforcing accountability and is a part of the external control over the administration. Audit, in simple words, means the examination of accounts with a view to determining their correctness.

Audit is a quasi judicial function as compared to accounting which is an executive function. Under the audit, the accounts are checked from the point of view of

- (i) legal availability of the money that has been spent
- (ii) ascertaining whether the money that has been spent on the activity for which it has been sanctioned by the Legislature
- (iii) ascertaining whether it was disbursed to the right authority
- (iv) ascertaining whether all the rules and regulations of financial administration were observed or not; and lastly
- (v) to ascertain whether due economy, wisdom and faithfulness while spending the money was observed or not.

Comptroller and Auditor General of India

The Constitution of India has created the office of the Comptroller and Auditor General of India which is considered as the most important constitutional appointment. He is the head of the Indian Audit and Accounts Department and is the guardian of public funds. His independence is guaranteed by the following provisions contained in Article 148 of the Constitution of India:

- (i) He is appointed by the President of India, but can be removed only on address from both Houses of Parliament on the grounds of:

- a) Proved misbehavior
 - b) Incapacity.
- (ii) His salary and conditions of service cannot be altered to his disadvantage during his term of office.
 - (iii) He cannot hold any further Government appointment after retirement so that he may have no inducement to please the Executive. There was a great criticism when the retired CAG Mr. Ashok Chandra was appointed Chairman of the Finance Commission although the latter office could not be termed as an office of profit or an appointment under the Government.
 - (iv) The salary and other administrative expenses of his office and staff are a charge upon the Consolidated Fund of India and are non- votable.

All these provisions make the status position of CAG of India equivalent to that of a Supreme Court Judge.

Functions of CAG in India:

Comptroller and Auditor General in India is basically now an auditor, since the Comptroller functions have been almost taken away from him nowadays. His role is of advisory nature vis-à-vis the legislature and its Committee on Public Accounts. The Audit Report given by C&AG cannot be discussed directly in the Parliament. Instead it is first presented to the Public Accounts Committee (PAC) which discusses it and then gives its report which in turn is discussed in the Parliament. This arrangement has been made to safeguard the independent status of the C&AG. There is a possibility that while discussing the Audit Report in the Parliament, a few remarks of a personal nature could be made which would have an adverse effect on the independence of the C&AG in case a direct discussion of his reports are allowed in the legislature. The office of the C&AG performs audit of all the accounts where Public Money is involved i.e. C&AG does the audit of accounts of all the States, all the Central Government departments etc. He also performs audit on the organizations which are substantially financed by the Central Government (i.e. grants exceeding 50% of the total expenditure of the organization). Similarly if the money under the grant exceeds 5 crores (which may be less than 50% of the expenditure), then also the audit of

that organization is conducted by C&AG. Audit of the Public Sector Undertakings is conducted by commercial auditors; but the panel of such auditors needs to be approved by the C&AG. In addition to all this, the office of C&AG also prescribes the format of accounts for the states to maintain uniformity in the accounts of all the states and to enable the taking up of the consequent process of audit.

Duties and powers of C.A.G. of India

Article 149 of the constitution empowers the parliament to lay down the duties and powers of CAG. Until the Parliament does so, his powers and duties are to be governed by the (Conditions of Service) Act 1971. According to this Act his duties are:

- (i) To keep the accounts of the Union and State Government and the accounts of Defence and Railways. With the separation of accounts from audit, part of these functions has been transferred from CAG to the Ministries of Government of India.
- (ii) To prepare accounts showing annual receipts and disbursements of the Union Government and the State Governments and to submit the same to the respective Governments.
- (iii) To prepare and submit to the President the General Financial Statement relating to the accounts of each year showing balance and outstanding liabilities and such other information as may be required by the President of India.

It is also the duty of the CAG of India:

- (a) To audit and report on all expenditure from the revenues of the Union Government and of the State Government. He has to ascertain whether the expenditure incurred as shown in the accounts has been disbursed legally and for the purpose for which it was meant and whether it has the proper sanction.
- (b) To audit and report on all transactions of the Union Government and the state Governments relating to debt, deposits, sinking funds, advances, suspense accounts and remittance business.

- (c) To audit and report on all trading, manufacturing and profit and loss accounts maintained by any department of the Union or the State government. The receipts of any Department of the Union or the State Government. Accounts of stores and stock kept in any office of Department are also included.
- (d) To give such information or assistance to the Union Government or State Government as may be required for the preparation of the annual financial statements.
- (e) To undertake such additional duties, as entrusted by the President for example, the audit of local bodies.

Audit report

Audit means the certification of accounts by the CAG as correct subject to such comments and remarks as he may chose to make. His comments and remarks are contained in the audit report which he submits to each of the Governments whose accounts he audits. The audit report for GOI is submitted to the President and the audit reports of the States are submitted to the respective Governors. The President causes the report to be laid before both the Houses of Parliament and the Governor causes it to be laid before the State Legislature. The Legislatures refer the reports to their respective PACs.

The report contains:

- (a) important financial irregularities ;
- (b) excess of expenditure over the grants sanctioned by the Parliament ;
- (c) over and under budgeting;
- (d) failure to obtain proper sanctions ;
- (e) cases of non-compliance with the rules and regulations ;
- (f) cases of improper expenditure; and
- (g) Cases of mis-appropriation and embezzlement.

The audit reports are then examined by the Public Accounts Committees and they, in turn, submit their reports to the respective Legislatures.

Chapter VII

Reserve Bank of India

A. Establishment

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. Since its inception, it has been headquartered in Mumbai. Though originally privately owned, RBI has been fully owned by the Government of India since nationalization in 1949.

B. Preamble

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

"...to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

C. Boards

i) *Central Board*

The Reserve Bank's affairs are governed by a central board of directors. The board is appointed by the Government of India in keeping with the Reserve Bank of India Act.

- Appointed/nominated for a period of four years
- Official Directors

Full-time : Governor and not more than four Deputy Governors

- Non-Official Directors

Nominated by Government: ten Directors from various fields and one government Official

Others: four Directors - one each from four local boards

- Functions: General superintendence and direction of the Bank's affairs

(ii) *Local Boards*

- One each for the four regions of the country in Mumbai, Calcutta, Chennai and New Delhi
- Membership: consists of five members each appointed by the Central Government for a term of four years
- Functions: To advise the Central Board on local matters and to represent territorial and economic interests of local cooperative and indigenous banks; to perform such other functions as delegated by Central Board from time to time.

D. *Financial Supervision*

The Reserve Bank of India performs this function under the guidance of the Board for Financial Supervision (BFS) which was constituted in November 1994 as a committee of the Central Board of Directors of the Reserve Bank of India.

Objective

Primary objective of BFS is to undertake consolidated supervision of the financial sector comprising commercial banks, financial institutions and non-banking finance companies.

Constitution

The BFS is constituted by co-opting four Directors from the Central Board as members for a term of two years and is chaired by the Governor. The Deputy Governors of the Reserve Bank are ex-officio members. One Deputy Governor, usually, the Deputy Governor in charge of banking regulation and supervision, is nominated as the Vice-Chairman of the Board.

BFS meetings

The Board is required to meet normally once every month. It considers inspection reports and other supervisory issues placed before it by the supervisory departments.

BFS through the Audit Sub-Committee also aims at upgrading the quality of the statutory audit and internal audit functions in banks and financial institutions. The audit sub-committee includes Deputy Governor as the chairman and two Directors of the Central Board as members.

The BFS oversees the functioning of Department of Banking Supervision (DBS), Department of Non-Banking Supervision (DNBS) and Financial Institutions Division (FID) and gives directions on the regulatory and supervisory issues.

E. Legal Framework

Umbrella Acts

- Reserve Bank of India Act, 1934: governs the Reserve Bank functions
- Banking Regulation Act, 1949: governs the financial sector

Acts governing specific functions

- Public Debt Act, 1944/Government Securities Act (Proposed): Governs government debt market
- Securities Contract (Regulation) Act, 1956: Regulates government securities market
- Indian Coinage Act, 1906:Governs currency and coins
- Foreign Exchange Regulation Act, 1973/Foreign Exchange Management Act, 1999: Governs trade and foreign exchange market

Acts governing Banking Operations

- Companies Act, 1956:Governs banks as companies
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980: Relates to nationalization of banks
- Bankers' Books Evidence Act
- Banking Secrecy Act
- Negotiable Instruments Act, 1881

Acts governing Individual Institutions

- State Bank of India Act, 1954
- The Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003

- The Industrial Finance Corporation (Transfer of Undertaking and Repeal) Act, 1993
- National Bank for Agriculture and Rural Development Act
- National Housing Bank Act
- Deposit Insurance and Credit Guarantee Corporation Act

F. Functions of the Reserve Bank of India

The Reserve Bank of India Act of 1934 entrust all the important functions of a central bank to the Reserve Bank of India.

Bank of Issue

Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations. The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the Government. The Reserve Bank has a separate Issue Department which is entrusted with the issue of currency notes. The assets and liabilities of the Issue Department are kept separate from those of the Banking Department.

Since 1957, the Reserve Bank of India is required to maintain gold and foreign exchange reserves of Ra. 200 crores, of which at least Rs. 115 crores should be in gold. The system as it exists today is known as the minimum reserve system.

Banker to Government

The second important function of the Reserve Bank of India is to act as Government banker, agent and adviser. The Reserve Bank is agent of Central Government and of all State Governments in India excepting that of Jammu and Kashmir. The Reserve Bank has the obligation to transact Government business, viz. to keep the cash balances as deposits free of interest, to receive and to make payments on behalf of the Government and to carry out their exchange remittances and other banking operations. The Reserve Bank of India helps the Government - both the Union and the States to float new loans and to manage public debt. The Bank makes ways and means advances to the Governments for 90 days. It makes loans and advances to the States and local authorities. It acts as adviser to the Government on all monetary and banking matters.

Bankers' Bank and Lender of the Last Resort

The Reserve Bank of India acts as the bankers' bank. According to the provisions of the Banking Companies Act of 1949, every scheduled bank was required to maintain with the Reserve Bank a cash balance equivalent to 5% of its demand liabilities and 2 per cent of its time liabilities in India. By an amendment of 1962, the distinction between demand and time liabilities was abolished and banks have been asked to keep cash reserves equal to 3 per cent of their aggregate deposit liabilities. The minimum cash requirements can be changed by the Reserve Bank of India.

The scheduled banks can borrow from the Reserve Bank of India on the basis of eligible securities or get financial accommodation in times of need or stringency by rediscounting bills of exchange. Since commercial banks can always expect the Reserve Bank of India to come to their help in times of banking crisis the Reserve Bank becomes not only the banker's bank but also the lender of the last resort.

Controller of Credit

The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit created by banks in India. It can do so through changing the Bank rate or through open market operations. According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons on the basis of certain types of securities. Since 1956, selective controls of credit are increasingly being used by the Reserve Bank.

The Reserve Bank of India is armed with many more powers to control the Indian money market. Every bank has to get a licence from the Reserve Bank of India to do banking business within India, the licence can be cancelled by the Reserve Bank if certain stipulated conditions are not fulfilled. Every bank will have to get the permission of the Reserve Bank before it can open a new branch. Each scheduled bank must send a weekly return to the Reserve Bank showing, in detail, its assets and liabilities. This power of the Bank to call for information is also intended to give it effective control of the credit system. The Reserve Bank has also the power to inspect the accounts of any commercial bank.

As supreme banking authority in the country, the Reserve Bank of India, therefore, has the following powers:

- a) It holds the cash reserves of all the scheduled banks.
- b) It controls the credit operations of banks through quantitative and qualitative controls.
- c) It controls the banking system through the system of licensing, inspection and calling for information.
- d) It acts as the lender of the last resort by providing rediscount facilities to scheduled banks.

Custodian of Foreign Reserves

The Reserve Bank of India has the responsibility to maintain the official rate of exchange. After India became a member of the International Monetary Fund in 1946, the Reserve Bank has the responsibility of maintaining fixed exchange rates with all other member countries of the IMF.

Besides maintaining the rate of exchange of the rupee, the Reserve Bank has to act as the custodian of India's reserve of international currencies. Further, the RBI has the responsibility of administering the exchange controls of the country.

Supervisory functions

In addition to its traditional central banking functions, the Reserve bank has certain non-monetary functions of the nature of supervision of banks and promotion of sound banking in India. The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction, and liquidation. The RBI is authorized to carry out periodical inspections of the banks and to call for returns and necessary information from them. The nationalization of 14 major Indian scheduled banks in July 1969 has imposed new responsibilities on the RBI for directing the growth of banking and credit policies towards more rapid development of the economy and realization of certain desired social objectives. The supervisory functions of the RBI have helped a great deal in improving the

standard of banking in India to develop on sound lines and to improve the methods of their operation.

Promotional functions

With economic growth assuming a new urgency since Independence, the range of the Reserve Bank's functions has steadily widened. The Bank now performs a variety of developmental and promotional functions, which, at one time, were regarded as outside the normal scope of central banking. The Reserve Bank was asked to promote banking habit, extend banking facilities to rural and semi-urban areas, and establish and promote new specialized financing agencies. Accordingly, the Reserve Bank has helped in the setting up of the IFCI and the SFC; it set up the Deposit Insurance Corporation in 1962, the Unit Trust of India in 1964, the Industrial Development Bank of India also in 1964, the Agricultural Refinance Corporation of India in 1963 and the Industrial Reconstruction Corporation of India in 1972. These institutions were set up directly or indirectly by the Reserve Bank to promote saving habit and to mobilize savings, and to provide industrial finance as well as agricultural finance. As far back as 1935, the Reserve Bank of India set up the Agricultural Credit Department to provide agricultural credit. But only since 1951 the Bank's role in this field has become extremely important. The Bank has developed the co-operative credit movement to encourage saving, to eliminate moneylenders from the villages and to route its short term credit to agriculture. The RBI has set up the Agricultural Refinance and Development Corporation to provide long-term finance to farmers.

G. Classification of RBI's functions

Main Functions

Monetary Authority

Formulates implements and monitors the monetary policy.

- Objective: maintaining price stability and ensuring adequate flow of credit to productive sectors.

Regulator and supervisor of the financial system:

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

Manager of Foreign Exchange

- Manages the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Issuer of currency

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

Developmental role

- Performs a wide range of promotional functions to support national objectives.

Related Functions

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

Offices

- Has 22 regional offices, most of them in state capitals.

H. Subsidiaries

Fully owned:

National Housing Bank (NHB)

National Bank for Agriculture and Rural Development (NABARD)
Deposit Insurance and Credit Guarantee Corporation of India

(DICGC)

Bharatiya Reserve Bank Note Mudran Private Limited
(BRBNMPL)

Majority stake:

State Bank of India