PUBLIC EXPENDITURE MANAGEMENT IN INDIA: AN OVERVIEW

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ABSTRACT

There are no two opinions on any Government's objective of removal of poverty. Sustained growth of the economy is considered to be a necessary condition to reduce poverty. Without macroeconomic stability sustained growth cannot be achieved. And continuing high levels of fiscal deficits pose a serious danger to macroeconomic stability. Fiscal deficits cannot be corrected without effective and efficient public expenditure management (PEM). PEM therefore has to be a central instrument of State policy and effective governance. This paper first traces the link between the ultimate objective of economic policy that of removal of poverty and public expenditure management. As governance encompasses PEM, the essentials of good governance and effective PEM are highlighted. With the purpose of assessing effectiveness of PEM in India a framework of PEM cycle is adopted. Each stage of the PEM is then assessed to identify the tasks ahead. An alternate assessment of the budget and financial management practices is also reviewed.

Key Words: Public Expenditure Management, Fiscal Deficit, Financial Management.

INTRODUCTION

Latest research covering the period of 1980s and 1990s shows that, as in the very long run, growth was a powerful force for reducing income poverty in countries. On average, growth in consumption of the poorest fifth of the population tracked economic growth one-for-one over this period. In the vast majority of cases growth led to rising consumption in the poorest fifth of the population, while economic decline led to falling consumption (WDR 2000-2001). A large number of factors including initial conditions, institutional capacity, right kind of economic policies including fiscal policy reflected in modulate budget deficits and the absence of high inflation, education and life expectancy are conducive to economic growth. The past few decades have yielded a rich crop of lessons about the kind of economic policies that support development. Analysis of these and other experiences consistently find a core set of policies that appear to be essential for growth (WDR, 1997): providing macroeconomic stability; avoiding price distortions; liberalizing trade and investment.

PEM as an instrument is indispensable to achieve the objectives of State policy. Macroeconomic stability requires, among other things fiscal discipline i.e. expenditure control; growth and equity requires, among other things, optimal 83 allocation and efficient use of resources including allocation of public money conducive to growth.

Macroeconomic stability could be endangered by high levels of fiscal deficits. Substantial evidence exists that, in most cases, fiscal profligacy is the main factor behind high inflation, increase in current account deficit (BOP) and finally sluggish or negative output growth. High levels of government borrowing (to meet revenue deficit in particular) can hamper growth of real economy by 'crowding out' private investment. It generates upward pressure on interest rates and also reduces the amount of funds available for the private sector investment. Besides crowding out, the public sector investment/expenditure may provide less efficient outcomes compared to the private sector. A recent result of an econometric exercise for Indian economy has shown that the reduction in the consolidated public sector deficit in the early years of 1990s was accompanied by at least a one for one increase in corporate investment which was the engine of three high growth years.

GOVERNANCE AND PEM

Governance encompasses the methods that societies use to distribute power and manage public resources and problems. It has been found that effective Governance is often the "Missing Link" between national anti-poverty efforts and poverty reduction. Even when a country tries to implement economic policies to foster pro-poor growth and mount targeted poverty programs, inept or unresponsive governance institutions can nullify the impact.

It being an instrument of governance the well known 'four pillars' of governance are relevant to PEM as well (ADB 1999). These are:

- Predictability : Lack of it undermines strategic prioritization, makes it hard for public officials to plan for the provision of services, is an excellent alibi for non-performance to boot. This is needed as a signpost to guide private sector decisions in production, marketing, investment.
- **Transparency :** The IMF assembled in 1998 a 'code of Good Practices on Fiscal Transparency' which covers : clarity of roles and responsibility; public availability of information; open budget preparation, execution and reporting; independent assurances of integrity. 85
- **Participation :** Needed for (i) sound formulation of expenditure programs; (ii) involvement of external entities; (iii) monitoring of operational efficiency and (iv) feedback.
- **Accountability :** For use of public money and for the results of spending it. All accountability must be for ‘performance' defined as 'achievement of agreed results within the funding provided, without diluting their quality and respecting the prevailing norms of due process.’

PEM : CONCEPT, OBJECTIVES AND DIMENSIONS

As already noted, Public Expenditure Management is an instrument of state policy. It is part of the system of governance. There is a necessary distinction between the expenditure policy question of 'what' is to be done, and the expenditure management question of 'how' it is to be done. Thus the techniques required for formulation of expenditure policy are different from the techniques of using PEM as an instrument to implement the policy. The information and data requirement of PEM would be different from those required for policy.

It also needs to be recognized that PEM in principle, is an analytical framework that enables the state to diagnose and give prescriptions for remedial measures for policy. PEM is not a panacea for mismanagement of macro-economy and poor budget outcomes. Finally, there is no one-size-fit all PEM theory. It is only a technique. Like any other technology from water pumps to agricultural fertilizers to construction public expenditure 'technology' must be appropriate technology, in terms of (i) local factor endowments, (ii) local institutions, and (iii) real local needs .

OBJECTIVES OF PUBLIC EXPENDITURE MANAGEMENT

Effective Government

- Provision of services to the public within specified time and cost schedules.
- Achievement of allocative and technical efficiency.
- Ensuring that budgetary intent and outcome are congruent.
- Matching outlays with resources.
- Provision of management flexibility to the implementation agencies.

Responsive Government

- Achievement of macroeconomic stability.
- Responsiveness to changing economic situations.
- Responsiveness to the changing needs of the client/consumer.
- Provision of a choice to the client/consumer.
- Promotion of a utilization culture in lieu of a spending culture.

Unstable Government

- Accountability for results
- Provision of accurate information on the status of government finances.
- Decision-making process to be transparent.

DIMENSIONS OF PEM

Even though PEM is an instrument of state policy and is to be used Achieve specified objectives of the policy, it has over the period of use, become ultidimensional.. The different categories of objectives to be pursued through PEM include:

- Economic and Financial
- Macroeconomic stability
- Effective budgeting
- Management aspects
- Financial discipline
- Efficiency gains
- Program and project management
- Financial disclosure
- Public interest requirements
- Transparency
- Accountability
- Client orientation
- Political aspects
- Political acceptability
- Citizen participation.

In a PEM framework there are a large number of specific and alternate techniques which can be utilized to achieve these objectives depending on the need, country specific circumstances, institutional capacity etc.

PEM IN INDIA: AN ASSESSMENT

An attempt has been made in this study to review, assess and find out the areas for reform in PEM in India. It adopts the PEM Cycle Framework used by the JBIC Institute in a study for Pakistan and Philippines. Both, the structural aspect (static) and the working aspect (dynamic) are analyzed for all the major elements in each of the stages of PEM cycle. There already exists an assessment of India's PEM based on World Bank framework. The ADB framework is largely based on the World Bank handbook.

Fiscal policy being an important component of the macroeconomic policy, the various stages of PEM cycle essentially starts from the stage of policy formulation for the budget. For the purpose of assessing the PEM in India, the method adopted here is to first view the system as it exists today, find the strengths and weaknesses of the system and finally to identify the tasks ahead for each of the stages in the PEM cycle.

PEM IN INDIA: POLICY

- Well organized system of policy formulation for the Budget
- Game players include Finance Ministry; DEA, DOR, DOE, Planning Commission, Ministries, PSEs. Financial Advisers' (FAs) play crucial role in sectoral policy.
- Extensive consultations with the Central Bank and representatives of Industry, Workers, Academia, Agriculture, NGOs, etc.
- Review of economy precedes the budget in the form of Annual 'Economic Survey' presented to the Parliament.
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Strengths

- Five Year Plan framework is available for annual Plan expenditure in the Budget.
- Macroeconomic perspectives are usually outlined in the budget speech.
- Periodically a Finance Commission recommends measures on consolidation of finances of both the Centre as well States.

Weaknes

- Very little feedback available with Budget makers.
- Rigidities do not permit sharp changes in policy particularly for inter-sectoral allocation .
- Very little scope of accommodating contingent requirements.
- Medium term policies for non Plan budget items not specified.
- Annual budget allocations are often not corresponding to the five year allocation made in the five year plan.

Tasks Ahead

- Medium term policies for the major budget supported programs need be formulated in advance (at least six month prior to finalization of budget).
- These policies should be strictly based on expert studies for new schemes and evaluation of impact assessment for the existing schemes.

PEM IN INDIA: EVALUATION

- As an integral part of the Planning Commission, Government of India, Program Evaluation Organization (PEO) evaluates plan programs.
- There exists a pre-designed built in system for evaluation of the programs/projects which are financed through external assistance/donor agencies. World Bank, JBIC and other donors evaluate their financed programs independently.
- Some of the programs are got evaluated by the government through external agencies/institutions (by giving grants).

Strengths

- PEO is a well established organization (since 1952) and has produced 177 evaluation reports.
- PEO can be assigned any specific evaluation study by the Ministries or the Planning Commission.

Weaknesses

- There is no regular mechanism for evaluating all the programs/ schemes in a time bound manner.

- The focus of the evaluation studies has been only on finding the constraints in implementation and general impact.
- Most evaluation reports lack focus on 3Es (Economy, Efficiency and Effectiveness) aspects of the expenditure.
- Lack of professionalism and expertise of the evaluators.

Tasks Ahead

- The focus of the evaluation studies has to be on 3Es.
- There has to be a consistency in evaluation studies in terms of a time bound schedule for all the major Program/schemes.
- Stakeholders, participants and beneficiaries of the programs should be closely associated with evaluation study.
- Encourage independent third party evaluation mechanisms on the pattern of donor financed projects.
- Adequate expertise and professionalism is required in the evaluation studies.

CONCLUSION

Removal of poverty is the ultimate objective, as it has been, for the economic policy of the Government of India. There is evidence to show that without a sustained higher growth rate, the objective of removal of poverty cannot be achieved. Macroeconomic stability is a necessary precondition for a sustained high level of growth rate of the economy. Continuing fiscal deficit particularly driven by the revenue deficit in the government budgets poses a real danger to macroeconomic stability. Public expenditure management (PEM) is the key instrument for correcting such fiscal imbalances. Also, an effective and responsive governance requires effective PEM. An assessment of PEM in India made in this paper brings out a large number of weaknesses notwithstanding the well established systems with some built in strengths. The assessment also identifies the major tasks ahead. Some other reviews of PEM have also made wide ranging suggestions for improving expenditure management in India. What is now needed is a holistic approach to remove the identified weaknesses at each stage of the PEM cycle rather than tinkering with a few sub systems without linking them to the ultimate objectives of an effective, responsive and accountable governance, as well as, PEM.

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