

REFLECTIONS ON
**BUDGETS AND GOVERNANCE
IN INDIA**

Vinod Vyasulu



Centre for Budget and Governance Accountability

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*He was thoughtful and grave — but the orders he gave
Were enough to bewilder a crew.*

*When he cried “Steer to starboard, but keep her head
larboard!”*

What on earth was the helmsman to do?

Lewis Carroll: The Hunting of the Snark¹

¹ The quotations before each section, are from Lewis Carroll, The Hunting of the Snark. Taken from <http://ebooks.adelaide.edu.au/c/carroll/lewis/snark/index.html>.

For
Jonna and Shivangi,
bold, fearless and supportive

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FOREWORD

Centre for Budget and Governance Accountability focuses on government finances in India with reference to some of the major challenges in governance and some fundamental concerns with the fiscal policy framework in the country. Research on these challenges and concerns shapes most of the interventions made by the organization.

Joining the Think Tank Initiative of the International Development Research Centre in 2010 led us to re-emphasize 'enhancing the quality and capacity of our research' as one of the goals for strengthening CBGA and improving its influence. One of the measures we have taken in this regard is to have Dr. Vinod Vyasulu (founder and former Director of Centre for Budget and Policy Studies, Bangalore) as a Special Advisor to CBGA for our research on issues pertaining to taxation, Centre-State fiscal relations and fiscal decentralization. Dr. Vyasulu has also been among the founders of CBGA and is well known for his pioneering work on decentralization and fiscal policy issues.

Over the last one and a half years, the research staff at CBGA have had interesting and substantive discussions with Dr. Vyasulu at regular intervals. On most occasions, these discussions have focused on 'difficult' questions pertaining to the fiscal policy framework in the country. These questions are difficult in the sense that they refer to issues, which are fundamental and hence tend to be taken as given or unchangeable by many people. However, neither Dr. Vyasulu nor we at CBGA perceive those fundamental questions about the fiscal policy framework as settled.

In this booklet, Dr. Vyasulu captures a significant part of these interesting discussions; he raises a number of issues / questions about government finances in India that are very pertinent yet little discussed. More importantly, he articulates his views, insights and questions in a manner that is very accessible for a wide range of our potential readers. I hope this booklet will serve its purpose very well, which is to urge many more people across the country to engage with some of the major concerns about governance and fiscal policy framework in India.

Subrat Das
Executive Director, CBGA

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*The Bellman himself they all praised to the skies —
Such a carriage, such ease and such grace!
Such solemnity, too! One could see he was wise,
The moment one looked in his face!*

I am grateful to the Centre for Budget and Governance Accountability in Delhi for inviting me to be a mentor and consultant on matters bougette², and for the discussions on data and detail that I have had with the lively staff there that led to the writing of this paper.

The Executive Director, Subrat Das, and the Research Co-ordinator, Pooja Parvati, in particular, have been most courteous and helpful, asking questions, making suggestions, and [very] politely disagreeing when required. Praveen Jha, who spends a great deal of time with the staff in CBGA, has smilingly raised difficult questions which he would go on to clarify in crystal clear Hindi. I am thankful he omitted Greek. I can only hope I understood him properly. My discussions with the entire CBGA staff have shaped this paper. I am grateful to them for the time given so generously.

My colleagues in the Centre for Budget and Policy Studies in Bangalore have seen these ideas and theories pop up at random in internal discussions in the past few years. Director Jyotsna Jha has always been supportive and helpful. From Srinivas Kumar I learned much about the practice of accounting and auditing. The questions raised in CBPS have helped me to present this technical, sometimes abstruse, always boring material in a manner that is hopefully much more understandable to the practitioners of budget work who may happen to read this. The friendly ambience of CBPS has been like a much needed tonic to me.

I am indebted to Shiv Karan Singh for bringing the General Clauses Act to my attention, and for explaining its importance.

An early version of this paper was given as the 13th Malayala Manorama Budget Lecture in Kochi on the 19th of March this year. The questions raised by the 800 odd people who turned up to listen to me have helped me understand what issues concern many people and to try and address them in this paper. I am grateful to the Malayala Manorama for the 13th lecture opportunity which has been I think especially fortuitous for me.

Samarthan in Bhopal also invited me to give a budget lecture, and this gave me the opportunity to try out some of these ideas on a different audience. I am grateful to Yogesh Kumar for this opportunity, and those who attended for their questions.

² For more interesting trivia on this topical and important subject, see, <http://www.guardian.co.uk/money/2004/mar/14/observercashsection.theobserver6>.

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For helpful comments on earlier drafts, I am beholden to Shankari Murali, Maya Sitaram, and S. Varadachary. As peer reviewers for CBGA, Balveer Arora, Pulin Nayak, Amitabh Mukhopadhyaya and B. P. Mathur made many useful suggestions. The open two hour discussion on June 27th led to corrections, a deeper understanding and important revisions on the draft.

This paper raises difficult questions and takes a rather uncommon position on many issues. Many of those, organisations and individuals, who have helped me, [and to whom I am grateful], do not necessarily share these ideas. I have not mentioned them here to share, even by implication, any blame for things that may be wrong.

I am also not following the great P.G. Wodehouse³ either, when he wrote: "To my daughter Leonora without whose never failing sympathy and encouragement this book would have been completed in half the time." In my case, without my daughters' support I would have done no work at all even if it were in double the time. To them I dedicate this tome.

For all errors of fact and opinion, I alone remain responsible. I would only hope I can learn and improve from those that remain.

³<http://www.iwise.com/CvI1E>

ABSTRACT

*He had bought a large map representing the sea,
Without the least vestige of land:
And the crew were much pleased when they found it to be
A map they could all understand.*

The Centre for Budget and Governance Accountability in Delhi has been involved in budget analysis in India for several years now. Apart from research on specific budget related issues, CBGA has also been interacting with NGOs across the country to get them to articulate their concerns in a way that could lead to specific budget proposals that could form the core of an advocacy programme. It organises several workshops to get NGOs to articulate their demands, and presents a memorandum based on these workshops to the Finance Minister before the budget is presented each year. As an institution located in the capital, it could play the role of an anchor in these matters. This experience has raised many questions about the work being done, and about the direction in which it must go in future.

This focus on the annual budget has meant that CBGA has got into a cycle of asking what, in a given sector, the budget has promised, and seeking information on the fulfilment of these promises. Often it has found that the government has not kept its promise. This has happened over several years. What then? Is this because the government found at a later stage that these were not the right things to do? Or there was a better thing they could do? Or was the system just incapable of doing the job? Or...

Should not, in such a situation, the focus change into asking if the government is doing the right things and in the right way? Even if it kept promises but they were biased to specific sections of the population, would not a need to search for the right policies [those that help the poor] be an obligation of CBGA? For example, if many of the social services were in the domain of the states, does it make sense to ask the union government questions of the state of say, basic education, agriculture or health? This has to be dealt with at the level of state governments. How should these issues be tackled by CBGA?

It is in this background that I have been interacting with the staff of CBGA. This process of discussion has led to joint discoveries about the federal nature of India's budget system, the centralising tendency in the way the Indian institutions in general, [and the bureaucracy in particular], work. We have come across the hierarchical thinking in which the 'Centre' is 'wise', the States 'foolish' and local authorities 'corrupt' that seems to dominate the discourse in Delhi. This view is completely in contrast with constitutional provisions which not only provide for multi level governance in the country, but which through constitutional amendments, have deepened the multi-tier structure of governance. Please note that governance is a rather complex function in this context; it is what many governments together do; not what the

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Government of India alone does...

These debates, and my own research on these questions, led to the realisation that it is essential for CBGA to work to develop a vision of the budget process in India in which all the tiers of government play their constitutional role. This paper is part of the effort to state these issues clearly. It became clear fairly early in the discussions that the structure of the budget process today is a historical legacy carrying within it the colonial origins. In the context of Independent India it has to change. So far such change has been a bit of an add on to what existed like the introduction of the Plan/Non Plan distinction, or the incorporation of the recommendations of Finance Commissions into the budget process. We now argue it must change in a much more fundamental way.

Bougette is an old French word for 'a little bag' or briefcase such as the one in which the Finance Minister brings his speech to Parliament., It is apt, I think, to use this word in the following discussion of the Indian budget process. I use the word 'budget' for the system that exists; and use 'bougette' for an alternative we must seek. The use of the word bougette helps to focus attention on these more fundamental issues of reform and change from existing practice. Such reform and change is essential for any progress towards an inclusive society.

That is the key message of this paper. To drive this point home we start with a puzzle from our currency notes, which will be clarified at the end of the discussion. This puzzle must be kept at the back of the mind as the discussions go through a description of the Indian budget process as it is today. This description stems from the several years of experience CBGA has had in budget analysis. Once this process is made clear, we move on to a discussion of what the 'disconnects' in this process are; they are to do with a top down structure having to work in a federal governance system of several tiers—spheres—of governance. Inter Governmental relations have to play a much greater role than is the case today. This naturally leads to the question of what is wrong and how it must be set right—the discussion in the section titled Function and Form. Once this is stated, the challenges to the budget process become easier to understand.

To end with a comment on the puzzle. The RBI notes were designed before Independence, when India was a colony. What we added later, was, I think, the pane with our languages in it. The Central Government is mentioned in the Government of India Act of 1919 and not in later documents. The administrative structure we work with has a long memory indeed.

The purpose of this paper is to get much greater discussion on these issues than has been taking place today. In the process the ideas developed here may need to be modified or changed—or dropped. I am sure that much needs to be done in filling out gaps, designing alternatives, learning how to push for change etc that need to be collectively created. How do we get that process going? That would show great progress.

BY WAY OF INTRODUCTION

*He had forty-two boxes, all carefully packed,
With his name painted clearly on each:
But, since he omitted to mention the fact,
They were all left behind on the beach.*

In this paper, I am concerned, not with the minutiae of the budget that the Finance Minister presented in Parliament on March 17, 2012; that has been much commented upon. I am concerned here with the way the budget process works in today's India. This is because I consider changes in the budget process to be essential to deal with the problems of inclusive growth facing this country. Such changes have not received the attention in economic literature that they deserve. Media attention remains focussed on issues of personal taxation, and major issues that powerful vested interests throw up, like the urgent need to trim the fiscal deficit. Basic issues unfortunately fall by the wayside.

Using the recent budget as an example for what happens each year, I propose to raise and discuss some issues about what an appropriate budget process should be. I argue that it is essential for India to change the manner of budgeting if the country is to solve the problems that face it. I see it as a necessary condition, it may not be a sufficient one. That is another question.

It is not my intention here to present the reader with an academic article, filled with references and footnotes. This is also not a manual on the budget⁴. Rather, it is my intention to present my arguments in a simple way, and to use this paper as a basis for further discussion and debate with those who deal with budget issues on a day to day basis. While it is based on my research, this is not a research report. The idea is to begin a discussion of these issues among thinking citizens. It is such discussion that is important, as it will enable each person to make up her mind on these not very simple issues. It is from such collective thinking that I expect new and better ideas and programmes to flower.

This paper is organised as follows.

Section 2 begins with a question and a puzzle that I think gives us a clue about how our governmental system works and to which I return later. This is a backgrounder to

Section 3 which describes the current budget process and presents some of the challenges the Finance Minister faced in preparing this year's budget. It also briefly mentions the choices he made in dealing with them.

Section 4 then goes into the basic issues of democracy, of representation, public services and taxation, and outlines some options that face a federal democracy like India. And the kind of options we as a society have. Based on this

⁴ There are several manuals and handbooks available on the Indian budget. Both CBPS and CBGA, with whom I am associated, have prepared them, and used them in training programmes. This paper is meant as a supplementary discussion piece for those who have gone through these manuals.

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Section 5 goes into fundamental issues of the bougette process—those of Function and Form. Is the form of administration and governance we have today consistent with the functions we expect our polity to perform? I argue it is not and go on to suggest what such consistency entails.

Section 6 discusses the challenges facing India from this perspective.

Section 7 concludes the paper.

A PUZZLE TO START WITH

*The loss of his clothes hardly mattered, because
He had seven coats on when he came,
With three pairs of boots — but the worst of it was,
He had wholly forgotten his name.*

Since budgets or bougettes are all about money, let me begin with a question that arises from the currency notes of India.

India's currency notes, from denominations of rupees two and above, are issued by the Reserve Bank of India. This is in line with international practice, where a central bank is the custodian of fiduciary currency.

If we look at the notes, we notice that each is signed by the Governor of the Reserve Bank of India, under the authority given to him by law. He 'promises to pay the bearer'...the amount mentioned on the note. It means that, if you go to him with a five rupee note, he will give you five one rupee coins. This is fine.

Above the signature of the RBI Governor, however, it is proclaimed in bold, "Guaranteed by the Central Government".

Why? India is a sovereign nation and the promise of its duly appointed Governor should be enough. Why is this Guarantee needed then?

I happened to look at the Tanzanian shilling notes. They carry no such guarantee. It is a sovereign country. So why do we in India have this?

Again, who is giving this guarantee? I have read the Constitution of India⁵, and nowhere is there a mention of a 'Central' Government in it. Our constitution provides for a union government and state governments, which are elected. So what is this Central Government that is giving the RBI Governor's promise a Guarantee?

Does—can—a constitutionally nonexistent entity give a guarantee? What does it mean? How can such a guarantee be enforced?

Think about this as we move on. We will revert to this question later.

⁵<http://indiacode.nic.in/coiweb/welcome.html>

THE BUDGET PROCESS IN INDIA

*Navigation was always a difficult art,
Though with only one ship and one bell:
And he feared he must really decline, for his part,
Undertaking another as well.*

There is a provision⁶ in the Constitution for the government to place before Parliament An Annual Financial Statement of the money in the Consolidated Fund of India. All money received by the Government must go into that Fund, and all money from it can only be spent on the basis of a law made by Parliament. It is a summary of these transactions over a financial year that is commonly referred to as 'the budget'. After debate, Parliament passes two Bills—the Finance Bill, which authorises the Government to raise revenue in various ways, including taxation, and the Appropriations Bill, which authorises it to spend money as approved from the Consolidated Fund of India⁷. There is a similar procedure in the States.

This financial statement is an accounting to Parliament of the money handled by the government. Ordinary citizens can use this information to see if the government they have elected is doing what it promised to do. Citizen groups analysing budgets have taken this up across the world. India is no exception to this trend of using budget data to try and hold government accountable.

How much has it spent, and on what items? How has it financed that expenditure? Who has benefitted from it? On whom has the tax burden fallen? In this sense the budget is an accounting exercise, and the budget is presented as a set of accounts. The main parts are the Revenue Account, which deals with the flows of money in the year in question, and the Capital Account, which deals with long terms investments, like those in setting up public sector factories.

In the budget, the government gives details of what it intends to spend in the coming year on various items. These are categorised into General Services, Economic Services and Social Services and a graded code is used for each item. These numbers are budget 'estimates'. It also provides information on how much it has spent of the estimates it made for the previous year on various items. These are the 'revised' estimates since they pertain to the financial year about to close and the government has some idea of what it has done. There is a third set of important numbers on what, after audit, are the actual expenditures on various items. These are referred to as 'actuals' or 'accounts' figures. This information is presented on both Revenue and Capital Accounts.

This annual financial statement enables Parliament to trace how a government has planned its

⁶ http://en.wikisource.org/wiki/Constitution_of_India/Part_V#Article_112_.7BAnnual_financial_statement.7D, Article 112.

⁷ After the liberalisation process, which began in the 1980s and accelerated in the 1990s, the role of government in the economy reduced. The nature of Planning changed. These were captured in the Fiscal Responsibility and Budget Management Act which obliged the government to eliminate the revenue deficit, and keep the fiscal deficit below 3% of GDP.

work and how it has implemented it, in terms of financial flows. After audit, the Comptroller and Auditor General of India submits to the President various reports on financial performance. The President has these reports laid on the table of the House. In the Lok Sabha, there is a Public Accounts Committee, chaired by a senior member from the Opposition, which scrutinises these reports and recommends action to Parliament. This completes the budget cycle—from planning expenditure to raising revenue to spending money on approved items, monitoring implementation, to auditing performance of that expenditure and taking action on the findings.

To meet its expenditure goals, the government has to raise money. In India, it is the union government that is responsible for collecting most of the direct taxes like income tax. The Constitution has provided for a Finance Commission that recommends how these revenues are to be shared between the union government on the one hand, and the state governments on the other. This is the vertical transfer of funds from union to states. The Finance Commission also recommends how much each state should get based on a formula it devises. This is called the horizontal transfer of funds across various states. As of today, just over 30% of the divisible pool is vertically devolved.

The recommendations of a Finance Commission are valid for 5 years, after which a new Finance Commission is set up. The last one was the 13th Finance Commission. One can expect the 14th Finance Commission to be set up next year.

Of the amounts that are transferred from the union government to the State Governments some come under the constitutional scheme of tax sharing and devolution. These are shown in the union financial statement as 'Transfers to the States' and in the State budgets as 'State Share of Central taxes'. These are unconditional grants. They are the constitutional right of the states who may use them as they please.

From the union share of revenues, it has become a practice for the union to frame 'schemes' on matters of national priority as part of the Five Year Plans and help the State Governments to implement them by transferring funds for the purpose. Political approval for these Plans is given by the National Development Council, which is chaired by the Prime Minister and has all the Chief Ministers as members.

These funds are routed through the Planning Commission—a body set up by Executive Order with the Prime Minister as Chairman—and are referred to as 'Plan funds'. In the budget documents, this is shown by a distinction made between 'Plan' and 'Non Plan' funds for various items. In order to ensure co-ordination in the transfer of funds to the state governments, with the Finance Commission, it has become a practice to associate a member of the Planning Commission with the Finance Commission.

Plan funds are conditional grants or sometimes loans to the States for specific purposes decided upon by the union government.

In the 2012-13 budget of Finance Minister Pranab Mukherjee, Gross Devolution and Transfers (GDT) from Union to States from the union's share of taxes has fallen from more than 7% of GDP in 1990-91 to about 5% of GDP in 2012-13 (BE).

Question: What exactly does this 2% fall mean for governance in India?

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When projects are financed by loans or borrowings, some of the funds passed on to the States are given as a mixture of grants and loans. The share of grant has been varying. The logic behind the loan is that the State must contribute towards repayment, and it can do this from the revenues generated by the activity for which the loan was taken. This is sound when it comes to productive economic activity like new factories. They would generate revenues that will help repay the loan. But if such funds are spent on social sector projects, or public utilities like urban metros, there is no scope for revenue generation and thus it is impossible for a State to repay its loan. This has gone on for some time now, and many States are in dire straits. In recent years, with a falling rupee, the loan burden has increased, making the problem much worse.

The Plan transfers, on the other hand, are meant for specific schemes and are linked to Guidelines framed by the union government. In some cases, Plan schemes require a contribution from the states, which may vary in percentage terms [20-30%] from scheme to scheme. Through such 'Plan' Schemes, the union can set national priorities even in items that are not on the union government list of responsibilities. [List 1, 7th Schedule]

Taken together with the budgets of the State Governments, one can get a complete picture of the financial condition of the country. The Reserve Bank of India produces each year a very useful compilation of such information.

Many evaluations over the years have shown that these schemes have been poorly implemented across the states. While the pattern varies across states, it is agreed that they have failed to meet the goals set, that there have been time and cost over runs, and that often the benefits have not gone to those they were meant for. A major reason for this, across the reports, is the rigidity in the schemes design and the inability or unwillingness of the local bureaucracy to make local changes needed for successful implementation.

In the recent budget, in 2012-13 (BE), total allocation for schemes in the Department of Rural Development has declined to Rs. 73175 crores from Rs. 74100 crores in 2011-12 (BE). The Revised Estimates (RE) for 2011-12 stands at Rs. 67138.5 crores, **which means what was allocated was not spent last year.**

The Union Government's total expenditure on the rural economy of India (which includes expenditure on Agriculture and Allied Activities, Rural Development, Special Area Programmes, Irrigation and Flood Control and Village and Small Industries) has declined from 2.6 percent of GDP in 2010-11 (Actuals) to 2.3 percent of GDP in 2012-13 (Budget Estimates). Less money is being spent in the states.

Question: What do these changes mean for ordinary citizens?

Budgeting is a technical exercise. What is important, and often not explicitly stated, is that this annual financial statement or budget, is prepared by experienced civil servants under the direction of an elected government in a political context. Civil servants everywhere are conservative, preferring the known and tested to the new and challenging. All elected governments have a base of supporters they must, in the very least, not alienate. All governments have been elected on the basis of promises made before elections, which they must try and fulfil, if they are to hope to retain office. Further, in any given year, there are committed expenditures that must be honoured. The scope for major changes is limited because of this. A government can only make radical changes over a number of years, not in one short year. Putting this differently, a Government must have a clear vision and set of priorities that it wishes to implement in its tenure in office. Economic reasoning has a place here, but, above all, a budget is a political document.

The budget gives the priorities of those in office, not necessarily of the interests of an abstract 'nation'. In a complex and diverse society like India, there will always be differences on these issues of priority. There will be differences in the approach to finding solutions. Democratic politics is the path we have chosen to bridge these differences. Groups that feel the priorities are not correct have to work to change them in at least two ways—by analysing what is being done, and showing how they would like it to be done. They have to explain why their way is better than existing practice. It is a big challenge for those in the field of budget analysis—or more accurately, public finance. In democracy, the power balances change with elections. Budgets will reflect such changes. For an excellent example see the work of the International Budget Partnership⁸ which gives examples from across the globe.

While economic logic and reasoning play a part in policy making, when it comes to budgets, it is politics that prevails. Parliaments must approve budgets, and they are political—in the best sense of the word. We must never forget that budgets are completely political. And that means that the solutions they look for are not necessarily permanent solutions to problems a country faces, but political solutions that will bring the party back to power. For example, a government may be interested, not in reducing illiteracy in the country as a whole, but in that part of it that may vote it back to office in the next elections. The fact that funds are always limited is used to justify making such choices. The short run view often prevails. It is up to those in opposition to take advantage of this myopia and form alternate strategies—or alternate budgets. In this context, there are no permanent solutions, no absolute values. Budgets can at best make marginal changes in any year. What works for a government is what will be chosen. There is no 'long run'; we have a collection of 'short runs' over time. The budget is not for idealists.

What are the main kinds of information we can get from a study of the union budget? There are many things one can do, but I would mention three, in no particular order of priority, as being of prime importance. There are equally important issues not mentioned here, like the public debt. These then are only meant to initiate the debate.

One of course is about investments in matters that are the direct responsibility of the union government. In India, these are subjects like Defence, External Relations, Telecommunication, Posts, and so on. One can see what the union is responsible for in List 1 of

⁸<http://internationalbudget.org/>

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the 7th Schedule, and use budget information, which should include the audit reports, to deepen one's understanding of their functioning. The CAG's reports have been very important in recent years.

It is from the CAG's reports that major irregularities like that of the Bofors deal, which led to Rajiv Gandhi losing the elections in 1990, and the issues around the allocation of telecom spectrum, were exposed⁹. The CAG submits a large number of reports, which are available to the public once they have been placed in Parliament. It is important the researchers and budget analysts go through them on a regular basis. After the Public Accounts Committee makes recommendations, the Government is expected to table an Action Taken Report. All these together are very important in enforcing accountability.

Railways is one such. How is the union dealing with the complex requirements of the railways? Rail transportation is crucial to the economy. Is enough being invested? Is technology being made use of properly? \what about safety issues? How does the government price rail services?

Question: There was much ado after the railway budget this year over a small increase in fares. The Railway Minister was forced to resign. What is really good for the railways to function in the long term?

Telecommunications is a union subject. There has been much controversy on telecom policy, especially on how spectrum has been allocated. The CAG has submitted some critical reports. Recently the Supreme Court has cancelled licences given by the union government. Such issues can be addressed in part, with budget data.

Question: What can we make out from information available in the budget documents about all this?

The second has to do with the macroeconomic health of the Indian economy. If the macro economy is out of balance, the result can be unemployment, inflation and so on. The union budget is by and large the biggest in the country in terms of revenues and expenditures. The states do have a role, but it is the union that is dominant. If the expenditures are more than revenues collected, how is the union dealing with the inevitable deficit? Are its policies stoking inflation? For example a high interest policy hurts small businesses. It may choose to do this if there is a benefit somewhere else. Who is getting the subsidy that the government is spending more than 2% of the GDP on? If it limits the subsidy, as announced by the Finance Minister, who are the ones who will have to pay more? Will it hurt the poor more than the non poor?

⁹ Currently, the draft report on allocation of land to Delhi International Airport raises questions of a possible loss of over one lakh crores. See <http://indiatoday.intoday.in/story/delhi-airport-land-deal-scam-cag-aviation-ministry/1/190015.html>.

The gross tax revenue collected under the Central Government tax system is projected to increase from 10.1 % of GDP in 2011-12 (RE) to 10.6 % of the GDP in 2012-13 (BE). In the budget for 2012-13, total union government expenditure is projected to decline marginally from 14.8 % of GDP in 2011-12 (RE) to 14.7 % of GDP in 2012-13 (BE). There is a deficit to be dealt with. Expenditure compression for reducing deficits is the distinct feature of this budget. This is a political choice. The Finance Minister could have chosen to increase taxes instead to reduce the deficit. But he did not do that.

Question: Why is there so little discussion about dealing with the deficit by increasing direct taxes? Or reducing subsidies for the rich?

In order to reduce the deficit without alienating its key supporters, the government can rob Gayatri to pay Savitri in complex economic strategies based on political calculations. All we have to do is ask how the government plans to reduce the deficit. The intention is declared in the budget; the mechanism has to be sought for from various sources. Consider the example below.

When the Oil and Natural Gas Corporation recently announced an issue of shares, the government compelled the government owned Life Insurance Corporation of India to buy the shares on offer. The market felt they were priced too high and avoided them. In doing this [a] the government transferred revenues of the LIC into its coffers [b] these revenues should have been accounted for in the Capital account, as the revenue came from sale of assets, but [c] the government used these as current revenues to reduce the defect, [d] deprived LIC of the opportunity of investing these funds in the best interests of its clients—you and me. This sleight of hand has not really been commented upon. But it is completely unethical behaviour, with short term political objectives in view.

Question: Is this an odd case, or are there more such instances? What is the impact of such deals? For whom?

In democracies, under the pressure of re-election, governments may be tempted to present a picture of the economy that may economise on truth. There is often a disconnect between what the public perceives, and what the government claims, about deficits, inflation rates and so on. There is need to examine government data claims carefully. The Greek Government politically manipulated its national accounts for years before the present crisis hit the county. And this malady is not confined to Greece alone¹⁰.

One of the items of expenditure proposed by the Finance Minister in this budget was the recapitalisation of public sector banks. Why has this become necessary? Banks earn profits. Part of the profit can be added to reserves or equity to increase the capital available. Why does government need to bring in fresh equity? Is it because these banks are not making profits—perhaps because of bad loans? SBI¹¹ has thousands of crores locked up in Kingfisher

¹⁰ <http://dailyreckoning.com/manipulating-the-masses/> . See also <http://schirachreport.com/index.php/2011/06/21/greek-crisis-originate-in-a-eu-system-in-which-breaking-the-rules-became-norm-says-mario-monti-with-no-independent-reviews-problems-stay-hidden/>

¹¹ SBI has a programme of corporate debt restructuring. These merit careful scrutiny. See for example, <http://www.thehindubusinessline.com/industry-and-economy/banking/article2755225.ece>

Airlines, and this is not likely to be repaid. If such amounts have to be written off—above the industry average—then the need for an infusion of equity from the owner arises.

Writing off such loans and recapitalising banks then means that a subsidy has been given to these industries, without quite saying so. Companies that took such loans, and their owners, get a benefit that is paid for by tax payers like us.

Question: Has this happened? At union and State levels? How big are the rescheduled loans? Is it a minor problem?

One would need to look at data on commercial loans and repayments, available from the RBI, to get a deeper understanding¹². One needs to consult people who have in-depth knowledge of the various sectors of the economy. Any macroeconomic situation can be consistent with many different kinds of microeconomic realities. There is no substitute to a systematic back and forth kind of analysis. There are complex issues of political economy, of equity and so on involved here.

This is an excellent example of how the budget enables us to ask questions which need information from other sources if they are to be answered.

In India there is general agreement that the poor do merit subsidies to survive, but is the government ensuring that they do get what they are supposed to? Does the fertiliser subsidy go to farmers or not? There are many such questions that can be asked from the union budget. They must be asked, and the implications of the answered explained.

The third has to do with the way taxes are raised. To this I return later.

In sum, a budget is like a clothes hanger. It holds a suit, but if you need information about the cut, the quality of the cloth etc, you need to move beyond the hanger. Another simile is the human skeleton. It keeps the body together, but tells you little about the condition of the lungs, the kidney or the heart. For that one needs to move on to other levels.

The budget is a starting point to ask questions. To find answers we have to find other sources and use other methods. The institutional context in which budgets are made is of fundamental importance. To some of these matters we now turn.

We must not expect too much of budget analysis. It is no *dues ex machina*.

¹² Consider this report, for example: <http://www.deccanherald.com/content/259320/evergreening-loans-major-ill-indian.html>. Restructuring of loans rather than classifying them as bad debt is perhaps not a desirable practice.

DEMOCRACY AND THE BOUGETTE PROCESS

From Independence in 1947 India has chosen to be a democracy, with universal suffrage. Its financial structure is built within the democratic framework. Compatibility between the democratic structure and the administrative and financial structure is essential for the smooth functioning of the financial system to achieve democratically set goals. The fact that many of these goals—from complete literacy to good health to full employment to vibrant agriculture, this list can go on—are being missed year after year suggests that something may be wrong. I will address this issue by first making a few points about our democracy, and then move on to the financial and administrative structure that has to implement these chosen goals.

India is described as a union of states. The word 'federal' does not appear in the Indian constitution. But it is the term in political science for any system of governance in which responsibilities of the nation state are divided across tiers of government¹³, each of which is elected. In India, there is such a distribution, mentioned in the 7th Schedule to the Constitution, between the union government of India and the various state governments. After the 73rd and 74th amendments, constitutional status has been given to a whole range of what we call 'local self governments'¹⁴. The 11th and 12th Schedules, listing subjects that could be made the responsibility of these elected local self governments, were added to the Constitution. These are not mandatory. In essence, this is a federal structure. I will deal with it in that way.

When it comes to financial flows, India is federal in the following way:

There is a division of responsibilities between the union government and the state governments, in the 7th Schedule already referred to. The residual items in India are the responsibility of the union government. The 73rd and 74th constitutional amendments, now operational, deepen this federal nature of the constitution. We must note here that there are many unique features to the Indian constitution.

There is a provision for Finance Commissions [Article 280] to be set up every 5 years, to recommend how the revenues collected by the union are to be shared. By convention, these recommendations are always accepted.

There is a provision for an Inter State Council [Article 263] to deal with disputes between the union and the states. This is an excellent example of institutionalising inter governmental relations.

After the 73rd and 74th amendments, a series of provisions for 'local self governments' have been made in the Constitution, which effectively deepen the nature of federalism in India. These amendments have provided for state finance commissions to recommend how state revenues are to be shared with local self governments.

While all this is true, the Indian constitution has given the union some special powers that such governments in other countries do not have. This is largely in line with the Government of

¹³ <http://www.forumfed.org/en/index.php>

¹⁴ On the use of this term, see Arkaja Singh, "Local Self Government in Colonial India: Self Government by Natives and the Development of Municipal Institutions", 2010, CBPS Bangalore.

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India Act of 1935¹⁵ passed by the House of Commons to govern British India. Indian federalism is unique in this respect. For example, all residual items—not mentioned in the 11th Schedule, are the responsibility of the union. The constitution gives powers to the union to give directions to the States under certain circumstances [Article 256]. Article 356 gives the union the power to dismiss elected state governments. Thus there is a strong centralising tendency in the federal nature of the Indian union. My arguments are based on the view that we as a country have swung too far to the union in the way the country functions¹⁶, and this is acting as a brake on our potential by not freeing the potential of States and local bodies. I elaborate in this below.

Generally it would be inadvisable to swing to either extreme allowed by law. There is need for judicious caution and mature and restrained judgements in this range. But there is space here for many ways of functioning. It is within these parameters that we must talk of reform and change. Amending the constitution is not easy, and it should be a last resort.

In a democracy, people elect their governments. In order to meet the expectations of the people, these governments have to spend money and they have been given the powers to levy taxes. How is this power used? The principle is simple in representative democracy: no taxation without representation¹⁷. It can also be turned around: No representation without taxation. The power to tax is an important one. How do democracies use this power? How should they use this power?

The power to tax is distributed between the union and the states, and between the states and local self governments. Direct taxes are collected by the union; some indirect taxes by States. This is a constitutional mandate. To ensure that funds are equitably shared, the constitution has brought in the institution of Finance Commissions. There are currently proposals to amend the constitution to bring in a Goods and Services Tax across the country. This matter is under debate.

The literature on public finance is clear that there are some principles that guide direct taxation. One is coverage—as large a percentage of the population as possible should pay taxes. One can understand that children and senior citizens who no longer work cannot pay taxes. Exemptions can be made for this.

The reason for this is simple. When one pays taxes, one is concerned about how that money is used. What are we getting in return for the taxes we pay? Are the public services like sanitation and so on of acceptable quality? What security do we get for each rupee spent? Are we getting the maximum possible or is too much being spent in a wasteful way? How can we use technology to improve implementation? These questions will agitate the minds of those who pay taxes, not of those who don't.

Of course, if everyone sees corruption in the provision of public services, and even these are of poor quality, there may be a reluctance to pay taxes, which will be seen as money going into the

¹⁵ <http://khadc.nic.in/snippets/The%20Government%20of%20India%20Act,%201935.pdf> Note that the provision regarding the formation of the federation never came into operation and this Act was only introduced only in the provinces where elections were held and provincial governments took office.

¹⁶ For example, the 42nd constitutional amendment took education, which was a state subject, and placed it in the concurrent list, thus giving the union a role in matters of education.

¹⁷ For example, see <http://www.u-s-history.com/pages/h640.html>

wrong hands. Those who can afford it will opt out of the system and look for private solutions, like sending their children to private schools or getting medical treatment in private hospitals. They may argue that because they use no such services, they should not be asked to pay taxes. This needs debate. What are their obligations as citizens? If they can opt out of paying taxes, can they demand the right to vote? Do they not benefit from law and order ensured by the government? Citizens have some responsibilities, and paying taxes is one of them. There is no direct link between a tax paid and a service rendered. The right thing to do is face the problem and solve it, not try to opt out.

This 'opting out' [which is happening in health and education] will make things so much more difficult for those not in a position to pay for services. When those who matter no longer use municipal and other services, the quality of these services tends to deteriorate; there are no pressures in the system to see they work properly. The poor and needy suffer. This can become a Gordian knot that has to be cut if we are to progress. There is really no alternative to the public provision of essential services, but there is scope to define what 'public' means. There is scope for contractual arrangements. That is a public and democratic space, which a federal structure allows for, and which is well within the provisions of our constitution. Each country can make its own path. This is discussed in more detail below.

Thus, one must have a tax system that covers a large population. Today less than 5% of the Indian population pays income tax. The majority are out of the income tax net—and you can see the attitude they have to public property. For them, it is 'government' property, not theirs, as they do not pay tax. Damage to government property is not seen as a loss. This is something that must change, and it will change when more people become income tax payers. The design of the system must ensure that.

Then there is the principle of equity in taxation. Paying tax must not be an intolerable burden on anybody. This also means that those who have large income can pay more, not in absolute terms, but as a percentage. Thus income can be graded into blocks, with larger blocks being subject to higher levels of taxation. This is called progressive taxation. We must be careful not to overtax. In the 1970s, Indira Gandhi raised the marginal rate—the highest rate—to 97% of income in that bracket. It is no wonder that a culture of tax avoidance developed in the country. We are still suffering the backlash.

Today the marginal tax rate is 30%. Is this too low? In the UK it is over 50%. Most European countries have a higher rate. There is nothing sacred in having only three tax income slabs. For those with high incomes, 40% and 50% is not excessive by global standards. Can we not think in terms of a system in which those with low incomes—say thrice the per capita income, or some such formula based figure, pay 3% as income tax? It need not be strictly monitored, living it to employers to deduct it from salaries. This would make them tax payers who worry about misuse of tax money and poor maintenance of public property like buses. Then we can have graduated slabs with the highest earners paying 50%. Such a scheme must have very few exemptions. Agricultural income above a threshold should be subject to tax—even if this requires a constitutional amendment. Such a tax system will make most people stakeholders in government. It would add quality to their democratic right as voters.

There is another issue to consider from an equity point of view when it comes to incomes. All

incomes cannot be treated equally. Most of us work for a salary; what we make from this is earned income. For some, like government servants, part of the salary is deferred and paid as a pension. Pension is earned income paid at a future date.

There are senior citizens who have no pension, and who live on interest earned from their savings. There is a case for lenient treatment of the income of senior citizens who live on such incomes. There could be a ceiling for such income that keeps it out of, or in a low, tax slab.

There is unearned income; this is what people get from interest on inheritances or from windfall gains from the financial markets through speculation in shares—the so called investment banking. These incomes derive from market movements, not from work put in. There is a case for a more stringent treatment of unearned income from an equity point of view. I would like to mention at this point that the United States of America treats such income favourably. That is why the investor and market guru Warren Buffet, who is worth billions of dollars, pays a lower rate of tax than his Secretary, who earns a salary. So long as the income tax law is clear, such tax treatment is not a disincentive for investments.

This leads to an issue we have been changing our national mind on. When the very rich die, should there be what is called a death duty or estate tax? That is a percentage of the property value goes to the national coffers before the heirs inherit the estate. India once had such a tax, but it has been abolished as part of the recent economic reforms. When Dirubani Ambani passed away, his estate, worth thousands of crores, passed on to his heirs without a rupee of tax being paid. This is clearly unearned income. India should bring back the estate tax. A country like the United States has such a tax. This is because they believe that becoming rich from inheritance is a feudal custom, where a son inherited a kingdom. In capitalism, one becomes rich by one's own entrepreneurial efforts. It is fine to look after one's children, but it would be wrong to deny them the opportunity to make their own wealth. Hence an estate duty is desirable, because even after paying it they inherit a great deal.

Another important question that has to be asked has to do with provisions in the tax code that permit exemptions from the payment of tax for defined activities. For example, to encourage R and D in industry, the Indian tax law permits a weighted deduction beyond 100% from income subject to tax. This is a huge incentive. What we do not know is what has happened in later years to the activity this incentive was given for. If it did fructify, it would have led to higher profits. Are such exemptions justified? Or are they simple manifestations of political power leading to economic gains for select groups? Would not a reasonable rate with no exemptions be better?

There is much debate today about the need to replace the Income Tax Act. The suggestion is that India needs a Direct Tax Code. Why do we have to replace an Act with a Code? Will the DTC become something like the Criminal Procedure Code, where each article is like a law?

Question: What is the difference between a Code and a law? Do we need a Code for taxes?

Another aspect of inequity is the reliance on indirect taxes like excise or sales taxes. These are paid by anyone who buys a product whatever their income. It is easy for policymakers to impose indirect taxes as they are not as visible as direct ones. But these taxes are far more

regressive in the sense that the burden falls disproportionately on people with lower incomes. This is however rather complex. Excise can be levied by both union and states; and sales tax is a prerogative of the States. Thus while the equity principle would require that a country try and rely more on direct, rather than indirect taxes, this is something on which political agreements are essential. .

Then how are these taxes shared with the states? How did the current lop sided vertical sharing come about? Given that developmental functions are with the States, should not a much larger share go to the States from the divisible pool? Should Plan transfers continue? These are things that can be changed by political decision, and do not require any legal changes. So why not?

When it comes to indirect taxes, there is a great deal of lobbying today to move to a Goods and Services Tax from the current one of sales taxes in the states¹⁸. This matter has been discussed exclusively from the commercial point of view. There is also a federal aspect, in terms of the powers of State governments. These issues must be addressed carefully. An Empowered Committee of State Finance Ministers is now considering the matter.

The fact that a large number of development schemes are central schemes decided upon by the union government, and funded through Plan transfers, also means that the distance between the citizen for whom the services are meant, and those who take decisions about these services is very large. If the public services we seek are local ones, like primary schools and primary health centres, then the responsibility for these should be at a level where people can vote on them. This is well known as the Principle of Subsidiarity. This was the reason for the 73rd and 74th amendments. The law has been put in place, but the distance, in term of funds and functionaries, has not been refashioned. These are matters that require careful design and not to be undertaken in a rush.

These are all matters that merit careful debate. The current tax system is out of line with the need to align voter responsibility with tax collection. The sharing of revenues is biased against the States. These fundamental issues have a lot to do with the kind of bougette system the country needs.

While local self governments¹⁹—the municipalise and gram panchayats—have the power to tax—say property tax—it is a fact that they collect very little. The decentralisation debate is an old one in India. The proposals made in 1907 are very similar to those we are discussing today.

This is another case of historical continuity. The difference lies in how the issue is posed. Is it a matter of decentralising administration? Or is it a question of working in a federal way?

Question: What is the difference in debating this issue in a decentralisation framework rather than a federal framework?

¹⁸ Attention must be paid to implementation and administration issues. The CAG points out problems of poor implementation in the Value Added Tax system introduced a few years ago.

¹⁹ See http://www.taxmanagementindia.com/visitor/detail_article.asp?ArticleID=1500.

http://books.google.ae/books?id=O9Wck_MEB9cC&pg=PA79&lpg=PA79&dq=The+Royal+Commission+on+Decentralisation+%281907%29&source=bl&ots=bmnTT3DbgU&sig=LsT8mRxlEVCYPqrFD87U5v6Q1_4&hl=ar&sa=X&ei=s5afT9ylOKj8iQLTYHHHAQ&ved=oCDIQ6AEwAg. It is interesting that this Commission, in 1907 used the term Local Government, not self government.

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In our country, while how much is collected is important, how it is shared is important too. Till now almost 70% of the Divisible Pool—the amount of tax revenue to be vertically shared between the union and states taken together—has gone to the union government.

True the union government passes some of this back through Plan Schemes.

Would it not be better if the union government was given enough to meet its constitutional obligations, and the balance left to the States which have onerous constitutional responsibility when it comes to the provision of public services?

Question: How is this to be done?

The same logic applies at the State Government level. When the state finance commissions make recommendations, how should the revenues be shared between the state government and the local self governments? I argue that today far too little is going to the local self governments. How do we plan to tackle this?

There is also the federal democracy aspect. In the union and in the states, Parliament and the state assemblies hold the governments to account. In India we have elected local bodies that simply exist; they have no role to play. Decisions are taken at the local level by the state government and the bureaucracy. This has been repeatedly shown in many studies. Reform in sharing tax revenues will not meet the criteria of no taxation without representation unless these elected bodies begin to debate and scrutinise local expenditures properly. For this they need their own staff. Today they function with the help of state civil servants. Will this have to change?

In what we continue to call local self governments, it is essential that the elected head be the chief executive, with the support of a number of competent civil servants working for the local body. They should implement the decisions of this local self government, whether it is rural or urban, within the subjects allotted to it by the State legislature. The State Government need not be involved in matters of implementation, but it will have other responsibilities—policy making, provision of resources, technology, training and so on.

Question: Would it be better to think of Local Government rather than 'urban and rural self governments'?

A Caveat

In the Indian context, we need an important caveat. Ours is a diverse country with a great deal of historical, regional imbalances on many dimensions. This regional dimension is in many ways the strength of our country, not its weakness. It is important to take note of this and build it into the way our federalism works. We need to work hard in an asymmetrical²⁰ federalism, and make it thrive.

In sum, we need to structure a system in which the union is enabled to meet its constitutional

²⁰ See for example, Alexandra Funk, <http://www.ie-ei.eu/bibliotheque/memoires2010/Funk.pdf>.

responsibilities and the states and local self governments theirs. Today the local self governments are starved of funds when it comes to the most important services. They have no staff, no executive functions, and no tradition of governance. This does not mean they are incapable or incompetent.

This is a major area that requires reform and change. We have to put our heads together and think on this carefully and come up with workable and acceptable suggestions. Each institution and agency will need to make its specific contribution to a larger effort. This is discussed further below.

OF FUNCTION AND FORM

*“What's the good of Mercator's North Poles and Equators,
Tropics, Zones, and Meridian Lines?”*

*So the Bellman would cry: and the crew would reply
“They are merely conventional signs!”*

Why do birds have wings?

Obviously, because they fly.

Why do fish have gills?

Because they live in water and this is how they breathe.

Why do people have glasses?

Because they may suffer from myopia or astigmatism or some such eye problem and these glasses help to correct their vision.

What do these examples show? They illustrate a basic design and architectural principle: form ever follows function²¹. The function of birds is to fly in the sky; the form is wings. From the purpose for which an entity exists, comes the form it takes. If one begins with a form, the entity will be limited to the uses it can be put. We face here an issue of institutional design. An institution here is understood as a code of behavior, not necessarily as a brick and mortar organisation.

It is relevant to us here because we are concerned with a question of design of appropriate institutions. Can we design a Form compatible with the Function to be performed? What should the architecture underlying the constitutional principles be? Specifically, given the democratic form of electing our governments, and the laws around the functions of union, States and Local Self Governments, what should the relationships between them be? Can we design new relationships, within the framework of the constitution that will give us better results?

Consider this report in DNA Bangalore on May 16th this year, on the front page²²:

BBMP ward health officer could be making up to a crore a month

²¹ The phrase is attributed to Louis Sullivan, an American architect. <http://architecture.about.com/od/greatarchitects/p/sullivan.htm>

²² <http://epaper.dnaindia.com/epapermain.aspx?edcode=860009&QuickEdition=yes>. The issue comes out clearly in two films from the Centre for Budget and Policy Studies, titled 'A Question of Equity' and 'The Story of Karwar', based on field research.

Chikkanna had demanded bribe from the owner of a bakery to issue a trade licence. He had originally demanded Rs 35,000, but agreed to settle for Rs 29,000. The complainant, KM Arun Kumar, had earlier given him Rs 15,000. After Chikkanna got his trade licence approved, he demanded the balance. Kumar reported the matter to Lokayukta police, who laid a trap to catch Chikkanna accepting bribe red-handed. When the Lokayukta police nabbed the health officer and checked his pockets, they were astounded to see that his pockets were filled with wads of cash, totalling Rs 3 lakh. He could not explain the source of the money. Lokayukta officials suspect that the amount was his “under-the-table earning” of the day. The officials said that if he makes Rs 3 lakh a day illegally by getting trade licence approved, he might be making close to Rs 1 crore every month. He could be collecting the amount from eateries and hotels on the pretext of inspection, the officials said.

Question: Was there no monitoring, that Chikkanna could collect bribes so brazenly?

The function here is regulation of bakeries and the like to ensure hygiene for health purposes. This is a function of local government, and so the responsibility of the Bruhat Bangalore Municipal Corporation. Mr Chikkanaa, the Health Inspector, is however an employee of the Government of Karnataka's Department of Health. His postings, future etc depend on the Department and not to the BBMP where he happened to be posted. The BBMP has no control over him, except perhaps the power to sanction casual leave. The form of administration is inappropriate, with the municipality having no control over its staff. The issue is not just that of the integrity of Mr Chikkanaa. It is an issue of the inappropriate design of our institutions.

The powers of the Corporation are vested in a Commissioner appointed by, and reporting to, the State Government. The Mayor has no powers to execute decisions; he or she merely presides over meetings. The elected body exists with no executive responsibilities. It cannot take decisions, hold staff responsible or initiate mid course corrections. Function and form are misaligned. The BBMP must have its own staff, reporting to the elected Corporation headed by the Mayor.

According to the BBMP Act, the budget of the BBMP cannot be implemented till it is approved by the State Government, which can make any changes it chooses—and has often done so. The BBMP is not a governance institution. It is a hangover of the colonial past. With variations, this is the case of municipalities across India.

The situation is no different in rural areas where the three tier panchayat system now has constitutional status. The elected bodies exist; our election system has performed well. But they have no staff and no financial powers. Again the form of the past continues to operate. Consider the way in which funds meant for the National Rural Health Mission in Uttar Pradesh were misused because of the bypassing of even existing procedures²³. In rural areas too function and form are misaligned. There is nothing in law that prevents a redesign—a fact attested to by the huge variety of structures that has been tried out across India. Unfortunately,

²³ <http://www.thehindu.com/news/states/other-states/article3474217.ece>. Once again from a CAG report.

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none of them lined form to function²⁴.

In other words, given the functions of each tier of government in India, what form should the structure of public administration take? It is a question of redesigning institutions.

This is an important question because it has not been asked till now. After independence, based on Nehru's views, India continued with the structure of the civil services that served British India. At that time it may have been important to do so. India was a new nation, struggling with the pangs of Partition and to integrate the more than 500 princely kingdoms that dotted the country. An experienced civil service was available, and it made sense to take advantage of it.

We also did not begin our national life as an independent nation on a clean slate. We kept on with the British way of doing things. Not only does our constitution draw heavily on the earlier Government of India Act of 1935, we also kept the laws passed by them on the books, until expressly repealed.

After the Mutiny of 1857, the East India Company that was Divan to the Moghul Emperor was wound up, and India became a part of the British Empire, with Queen Victoria becoming Empress of India. In the years following this, a number of laws were passed across a range of subjects²⁵. The British brought in what may be called a modern administration, led by the Indian Civil Service, which replaced the officers of the East India Company. These ICS officers were placed in the revenue district, and as Collectors [of revenue] they represented governmental authority. A number of powers were delegated to these officers, who by and large administered fairly, and were not prone to bribes and petty politics. To help them in administration, a whole range of laws were passed, from registration of births and deaths to inheritance, and more.

The British created institutions that enabled them to rule—a function they had taken over from the East India Company. This institutional structure became entrenched in India. Today, this structure 'controls' and runs the country whereas now the function is democratic governance. The two are misaligned. By a quirk of history, we have a situation in which function follows form. And changing this is the challenge before the people of India.

It may be useful to consider the idea of Function and Form through a real example.

In 1975 India launched the ambitious Integrated Child Development Services Programme as a centrally sponsored scheme, which means that the bulk of the finances were borne by the union. This is considered a successful scheme [1]. Let us focus here on the issue of Function and Form only.

The Function is clear enough. It is to improve the health of children and mothers through multiple interventions—nutrition, education, immunization etc:

Objectives: The Integrated Child Development Services (ICDS) Scheme was launched in 1975 with the following objectives:

²⁴ Vinod Vyasulu, Panchayats Democracy and Development....K.C. Sivaramakrishnan...Law...

²⁵ In fact the British passed a 'law of laws' which dealt with how terms are to be defined and interpreted when used in other laws. It is in this law that Centre, Central Government etc are defined. For details, see <http://sdoishnupur.gov.in/Acts%20and%20Rules/Dictionery/0701.pdf>

- i. to improve the nutritional and health status of children in the age-group 0-6 years;
- ii. to lay the foundation for proper psychological, physical and social development of the child;
- iii. to reduce the incidence of mortality, morbidity, malnutrition and school dropout;
- iv. to achieve effective co-ordination of policy and implementation amongst the various departments to promote child development; and
- v. to enhance the capability of the mother to look after the normal health and nutritional needs of the child through proper nutrition and health education.

Services: The above objectives are sought to be achieved through a package of services comprising:

- i. supplementary nutrition,
- ii. immunization,
- iii. health check-up,
- iv. referral services,
- v. pre-school non-formal education and
- vi. nutrition & health education.

The concept of providing a package of services is based primarily on the consideration that the overall impact will be much larger if the different services develop in an integrated manner as the efficacy of a particular service depends upon the support it receives from related services.

The objectives are met when the Services are effectively delivered. These services must be delivered to children and mothers where they live.

The Form of administration chosen was to set up the Women and Child Development Departments in the States to implement the ICDS. At the union level also there was a ministry of Women and Child Development to handle the funds, co-ordinate the programme, provide resources like training, and monitoring.

It was a top down scheme designed with the best of intentions. The delivery mechanism was the bureaucracy of the newly created department. A cadre of civil servants was created for this purpose. This is how Government in India—and therefore the Governments of the State--works.

The points to note are:

---the objectives of the scheme would be achieved at a defined future date. Would there be any need for a permanent ministry and department of officers and others on a long term permanent basis? What could have been managed with a special Project Team was instead made into a permanent ministry. This question was not even asked.

---there was no mention—no thought at all, of a local self government role. True this scheme was designed before the Ashoka Mehta Committee which recommended a panchayati raj system. But even after so many years, even after the 73rd amendment to the constitution has been operation for 15 years, there is still no role for local self governments in the ICDS.

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The appropriate Form for this scheme would have left the delivery of services to local governments through their own staff reporting to the elected; local government. The State Government would have taken responsibility for provision of resources, training, monitoring and the like. This is how a federal system would work.

Brazil has a similar programme that is implemented federally. It is a working system from which we can learn.

Let us consider some more examples of form not following function.

Agriculture is a State subject. Yet most agricultural policy is made in Delhi in the Agriculture Ministry, which the States are to implement. There is no link between what we grow and what we should eat. Millets are dismissed as inferior cereals, and rice is encouraged. When irrigation is available, farmers switch to sugar, which is a raw material for alcohol, and for white sugar.

Question: Do crops grow in Krishi Bhavan in Delhi?

Diabetes is becoming an epidemic in India and sugar is bad for health. Why should the country not grow crops that promote health rather than spoil it? Further why should subsidies be given for crops like sugar that destroy people's health. Let us also not forget that molasses, an ingredient in sugarcane processing, is the raw material for the alcohol industry. There is need for fresh thinking here, not just in terms of the inter-relationships, but also of the levels at which these decisions are taken.

Why should the union government have ministries in subjects that are exclusively in the domain of the States? These should be abolished, thus saving money by the right sizing of the government, and allowing each state to make policy for itself. It is open to State to cooperate with each other if they wish, without involving the union

Question: This may be a new arrangement, but is it not within the limits of the constitution?

Today one of the largest items among the subsidies is the fertiliser subsidy, which goes, not to farmers, but to producers of fertiliser. At a time of rising hydrocarbon prices, why not think in terms of a LISA—low intensity sustainable agriculture, such as organic agriculture, in which the union can help the states while the transition from the current high energy agriculture, is taking place to a LISA strategy? This is an out of the box kind of thinking on the fertiliser subsidy,

Another large subsidy is the food subsidy, which is today locked up in the complex Public Distribution System²⁶. There has been much research which has shown that the system suffers from many problems, and recently some evidence of improvements has also come in. But here again, there is no one who is making a case to continue the PDS as it is. Why should it subsidise

²⁶ It is believed that the PDS works well in Tamil Nadu and other states can learn from this experience. The CAG civil report for 2011 however finds that the number of ration card holders exceeds the population of the state. See <http://www.deccanherald.com/content/250297/in-tn-ration-card-holders.html>.

only rice and wheat, which again research has shown is bad for health? By subsidising it, the union government is encouraging a shift away from traditional foods and cereals like jowar, ragi, bajra and so many others. We have here a system that is expensive, that shifts people's tastes from what they are used to, and which brands healthy cereals²⁷ as 'coarse grains' and 'inferior cereals'. If the food subsidy issue is left to the States as it should be this overemphasis on rice and wheat will be replaced by a preference for what the state grows. Procurement can be local²⁸, with distribution also being local. The expensive operations of the Food Corporation of India will then no longer be needed²⁹. This requires a radical shift in our thinking—but not in our laws.

Why not design a state and local level food distribution system, with some union co-ordination, which enables the Food Corporation of India and its operations to be shut down? Brazil has such a policy and it works well.

Question: What can we learn from a country like Brazil?

How do we redesign our institutions to perform the function of effective governance in our federal polity? That redesign must include as an essential part, the bougette process. This is a large question and we can only explore the bougette part here. But this is the challenge facing us in India. Let us turn to it.

²⁷ For example, . Also National Institute of Rural Development, Hyderabad, National Consultation on Millets, June 5-6, 2008: God's Own Crops.

²⁸ Brazil has done this successfully as part of its zero hunger strategy. See VinodVyasulu, "Brazil's 'Fome Zero' Strategy: Are there any lessons for India?", Economic and Political Weekly, Volume 45, No 25 and 26, June 2010.

²⁹ See MilindMurugkar, 'Reforms in Food Corporation of India: Case of Wheat Imports', CUTS International, <http://www.cuts-citee.org/pdf/BP06-DI-2.pdf>.

CHALLENGES BEFORE INDIA

*“For the Snark's a peculiar creature, that won't
Be caught in a commonplace way.*

*Do all that you know, and try all that you don't:
Not a chance must be wasted to-day!*

There is a term in chemistry I would like to refer to. It is 'phase transformation'. The science may be difficult, but a phase transformation occurs when ice melts and becomes water, or water vaporises and becomes steam. The basic molecule is the same but its properties vary in the different states or phases. An 'impurity' acts as a catalyst in such phase transformations.

If we can pose our question as changing the phase of our administrative system—assuming this analogy is valid—we should look for that elusive impurity. Could it be what Amartya Sen has called public action?

The challenges to public action can be seen in both a short term and long term perspective. It would be wise in this matter to make haste slowly.

The short term action too will need preparation and hard work, and will take time to spread. It consists of an insistence by us, the public that our local self governments begin to act as such. Given that there are several lakh gram panchayats, and a few thousand municipalities in India, this is a huge task. How to organise for it, how to implement and monitor it, is a daunting challenge.

To help understand the current structure, the past structure and the new proposed one, some figures are given below. They show how the political executive, the civil servants interact under different conditions. The first is what built up after Independence. The second is the resultant structure after the 73rd and 74th constitutional amendments. The third shows what could aim for. The third falls well within the ambit of our constitution.

The public administration structure before the 73rd and 74th constitutional amendments was as shown below:

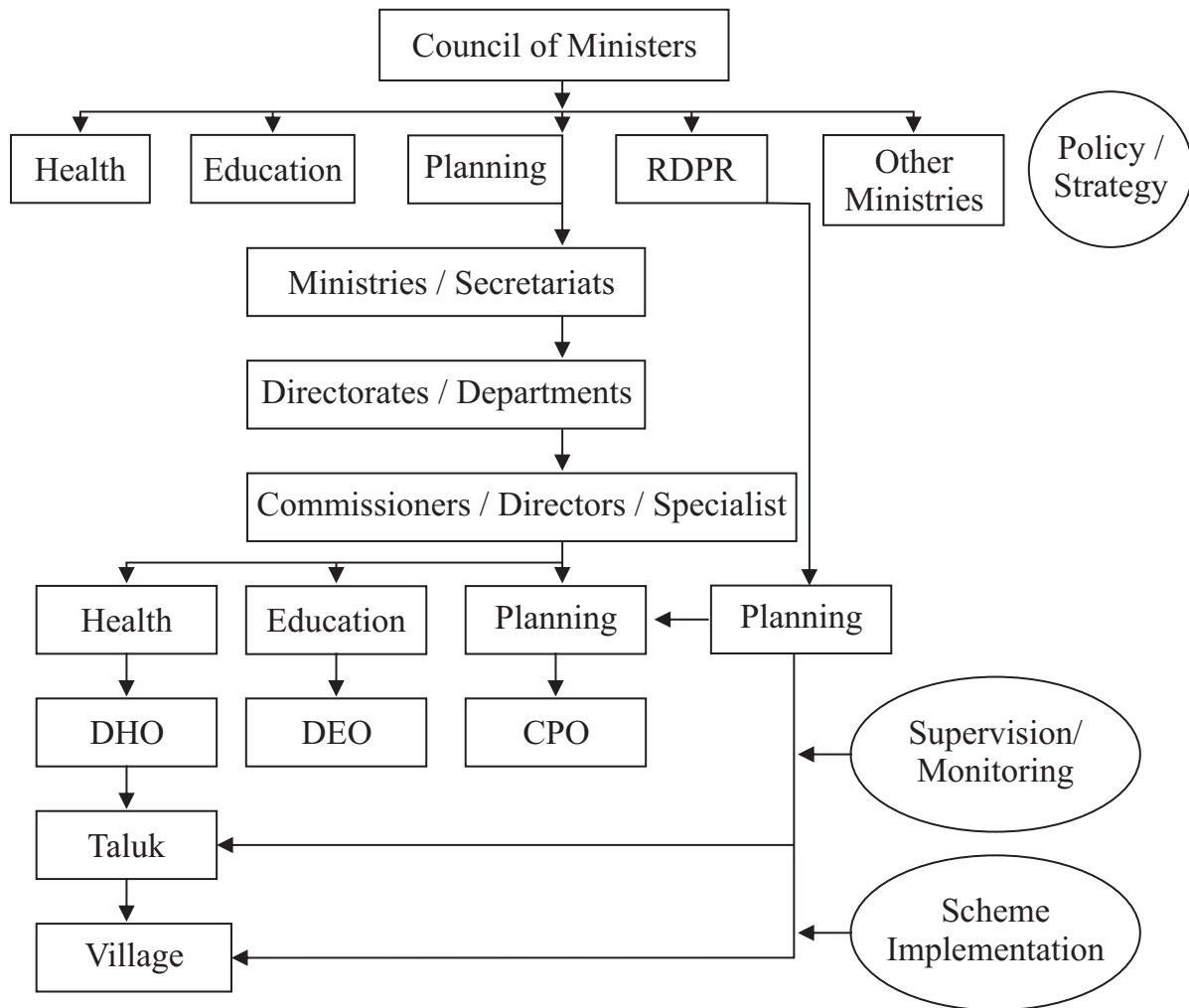


Figure : The structure of programme implementation before the 73 and 74 amendments.

Source: Vinod Vyasulu (2003) Background paper submitted to the (Justice M. N. Venkatachalliah) commission to review the working of the constitution

After the amendments came into effect, and LSGs constituted, the structure became as shown below:

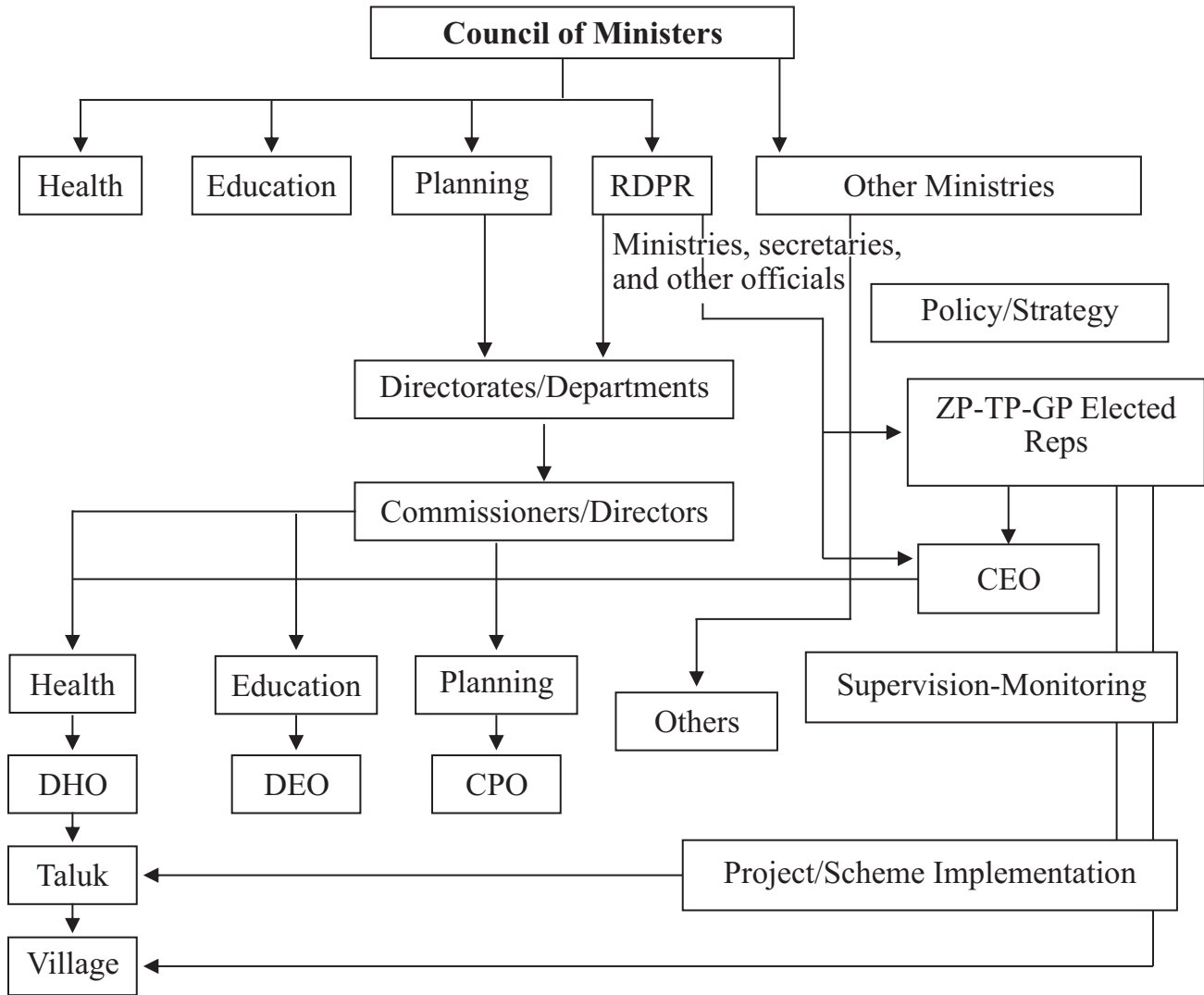


Figure : State government structure after 73rd Amendment
 Source: Vyasulu 2003:164

The current top-down service delivery mechanisms has been pictorially represented where departments are policy makers and implementers. They plan, implement, supervise and monitor their own programmes, which has significantly reduced the effectiveness of several programmes.

If the suggestions we make are implemented, the structure will change in form to something like the figure shown below:

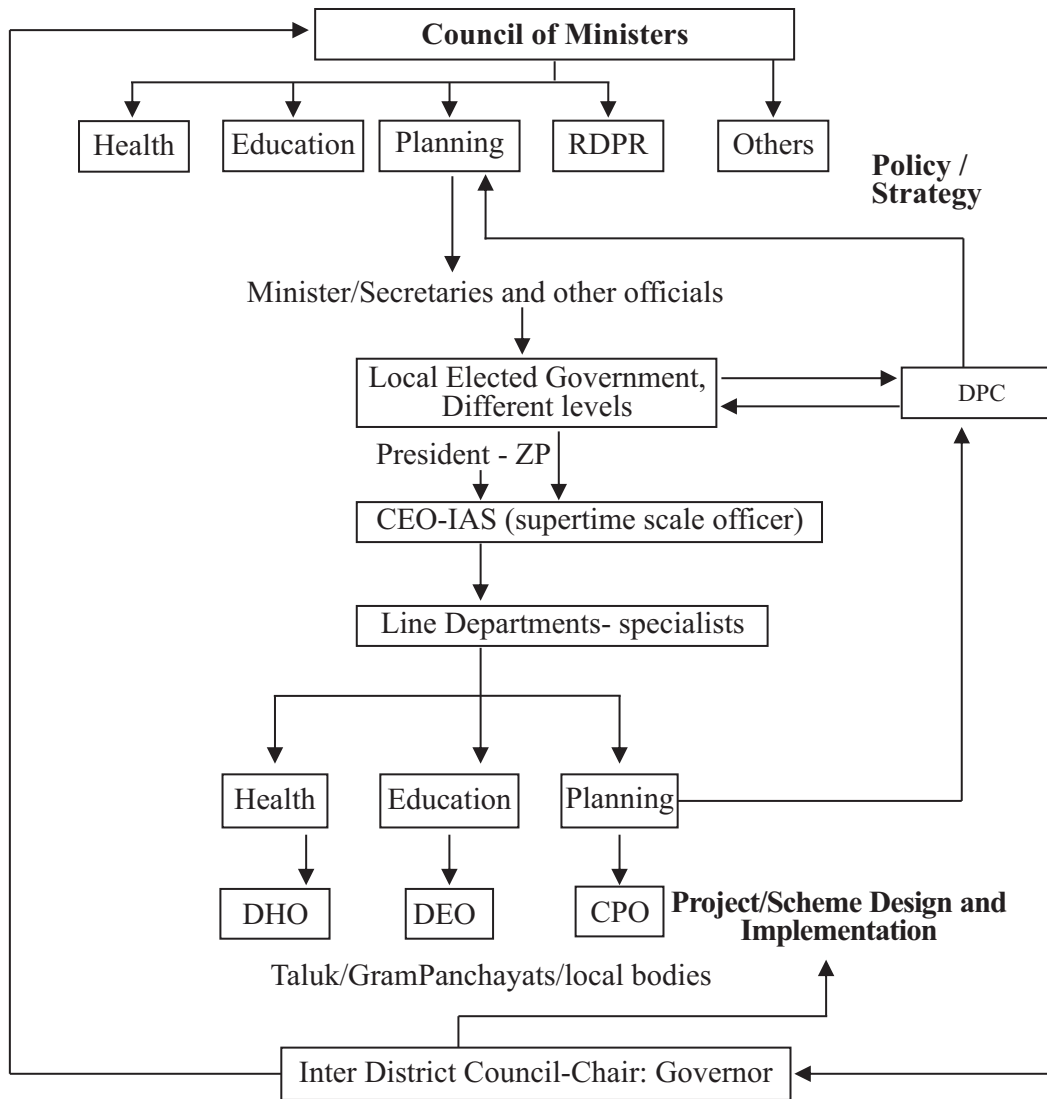


Figure : Proposed Government Structure
 Source: Vyasulu 2003: 169

This will need awareness and capacity building. The President, Adhyaksh, Sarpanch, Mayor, whoever chairs a local self government must insist of regular sittings of the elected body, with defined agendas for discussion, and for decisions to be taken by voting and recording of votes. They must then be implemented and monitored.

This will begin the process of officials compiling information for discussion in this body. It will give elected representatives a chance to get to know what is being done, how much money is available in the jurisdiction of their LSG, in their own ward, and it will lead to efficiencies

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because of the opening up of opportunities to club activities, to use, say NREGA on essential works for wages, to ensure that schools get health services, that the food distribution is on the right lines and so on. In short, the missing 'horizontal integration'.

This will be resisted by the local bureaucracy. They will argue that this is not the way things have been done—and they will be right. They will resent the oversight that this puts in place. They will argue that these 'non officials' interfere in work, and are corrupt. As of today we must accept that this is in part true and work to change it.

Civil servants will get orders from above, may even go to the courts on technical points, and may threaten strikes and so on. This is a deepening of federal democracy, and it will have to be faced down, not by police action but by patient reasoning with them, taking their concerns on board and finding acceptable solutions. Thus this Public Action is essential. What form it will take will have to be decided in each local area. It is no small challenge.

Over the longer term, Public Action has to demand a restructuring of the different tiers of government along constitutional lines. A Union ministry for States Affairs may be fine, but that is about all.

The Inter State Council, envisaged in the constitution must be taken out of the clutches of the Home Ministry. It could link up with the House of the States, the Rajya Sabha, with the Vice President serving as Chairman. We need debate and discussion on what its composition should be, what its normal duties should be, For example, it should be consulted when the Terms of Reference are being drawn up for union Finance Commissions. The doing away of the Plan/Non-Plan distinction may require a radical modification—even closure—of the Planning Commission. This is the kind of issue that will have to be faced and sorted out.

And within the States, one could think in terms of an Inter District Council, with all the District Panchayat Presidents as Members. The Chief Minister could also be a member in the IDC which should elect its own Chairman. One of the District President's could serve, by rotation, as Vice Chairman. The CM could be a permanent Vice Chairman. Different States could work out their own specific forms for this.

It is also important to remember that government, at any level, is accountable to citizens. Whether it provides a service directly, or through private agents, it is incumbent on it to ensure that contracts are properly written, checks put in place, monitoring is effective and so on. Consider this case of the Rajiv Gandhi Shilpi Swasthya Bima Yojana which was given to a private company to implement³⁰. How do these happen in reputed companies? How can we prevent this? This is the challenge³¹.

³⁰ http://epaper.dnaindia.com/story.aspx?id=21271&boxid=23443&ed_date=2012-07-02&ed_code=820009&ed_page=1

³¹ http://www.dnaindia.com/mumbai/report_icici-lombard-wins-bid-for-go-a-s-health-insurance-scheme_1554548

BY WAY OF CONCLUSION

*He thought of his childhood, left far far behind —
That blissful and innocent state —
The sound so exactly recalled to his mind
A pencil that squeaks on a slate!*

If I may borrow a phrase from Operations Research, the issue we are discussing can be called a 'wicked problem'. It is one where understanding is shaded, information both insufficient and contradictory, the objective goal posts shifting, and one in which a solution to one aspect may bring on a wicked problem as another aspect. Wicked problems are difficult to solve. Recognising this is an important first step. Contrast these with 'tame' problems, like building a road. Tame problems may be complex, may require high level skills, but they are clear about what is to be done to reach a stated goal. Management can deal with tame problems, but it cannot deal with wicked ones. There is no alternative to a political resolution to wicked problems. Some resolutions may be partial but that is the way of wicked problems.

After 1947, the Functions of governance have changed. This has also been recognised after the reforms of P.V. Narasimha Rao in 1991, when the 73rd and 74th amendments to the constitution were passed along with the changes in economic policy. A small step has been taken. But much has still to be done to implement these amendments in spirit.

When it comes to the Form of public administration that we have, there has been a remarkable continuity from the British Raj. Our constitution allowed for laws passed earlier to remain in force till explicitly repealed. In some case, they were passed *mutatis mutandis*, without radical change, after Independence, some of them at the state level. When it came to interpretation of terms, the General Clauses Act came into play. Even though there is no Central Government in the Constitution, it made it legal to use the term for the union government.

Thanks to the General Clauses Act, as amended since, The Law Commission notes: It may be noted though that since 1868 there were different constitution acts in force at different times yet Central Acts passed since 1868 have a certain amount of homogeneity. But the function has changed from colonial administration to democratic governance. We have to move with the times.

This is a realisation we come to from a study of our development experience. It is part of our historical evolution.

All this is not to say there has been no positive progress in India. The country has made remarkable strides in a number of fields, and we should be proud of these achievements.

But in the field of human development, of education, of schooling, of health and so on, we have

³² http://en.wikipedia.org/wiki/Wicked_problem

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lagged behind others. In asking why we have come up with the issue of Form and Function. The Form we had suited centralised administration in a large colony.

The human and social developmental activities which are the constitutional responsibility of the States required a federal way of functioning. We have mixed up Decentralisation [which deals with issues of where decisions can be taken in unitary governments like the UK] with Federalism in our debates.

Back to our currency note puzzle: Thanks to the General Clauses Act, the RBI can continue to use the term Central Government. But, I argue, that Act does not justify the Guarantee printed on the notes.

We have yet to convince the RBI that the Guarantee in the notes is not needed; that they must redesign the notes for an independent India. That may prove to be more difficult than making our local governments work.

Thanks to this, the RBI can continue to print notes with using the term Central Government. That term does not exist in the Constitution, but it is not illegal because The General Clauses Act ensures this.

Question: Does this Act permit the RBI to talk of such a Guarantee?

It is clear that there is a hard task for those interested in Public Action.

We cannot even convince one agency, the RBI, on this issue. Think of what it would take to change the way our institutions work.

But then, nothing worthwhile is ever easy. Let us relish the Challenge.

the 1990s, the number of people in the UK who are employed in the public sector has increased from 10.5 million to 12.5 million, and the number of people in the public sector who are employed in the health sector has increased from 2.5 million to 3.5 million (Department of Health 2000).

There are a number of reasons why the public sector has grown so rapidly. One of the main reasons is that the government has increased its spending on health care. This has led to a rapid increase in the number of people employed in the health sector. Another reason is that the government has increased its spending on education. This has led to a rapid increase in the number of people employed in the education sector.

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