Working Paper 2

Unpacking Public Financial Management (PFM) Issues at the District and Sub-district Level in India

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CBGA

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I. Introduction

Most federal-system countries with a decentralised fiscal architecture devolve the responsibility for implementation of development in social sectors such as health and education schemes, as well as provision of local public goods, to the lower tiers of government. Devolution is grounded in the belief that the closer governance is to the people, the more sensitive it is to local requirements. India is no exception. Public funds flow through multiple levels of government and administrative systems before they can be spent on the delivery of goods and services. In fact, even when public schemes are initiated at the Union level, such as Centrally Sponsored Schemes (CSS), implementation of these schemes rests at the sub-national level, particularly with states and districts.

Yet despite a significant amount of funds flowing to the districts, in India, currently, there is no concept of a comprehensive and collated district budget, making the estimation of local level expenditure an arduous task. Instead, most schemes run by both the Union and state governments have their own fund flow and administrative processes. While the availability of computerised treasuries in some states has in recent years opened the possibility of understanding district-level fund flows, these remain few and far in between.

The importance of understanding sub-national implementation is imperative given that districts and local governments even within the same state often have different characteristics and require unique development approaches. A lot of the literature on decentralisation of welfare programmes has focussed on capacity constraints in planning and implementation at the lower levels of administration. Yet, an often-overlooked aspect is the constraints in the current design of Public Finance Management (PFM) or the system of institutional rules, institutions and processes by which public funds are managed (Kapur & Shukla, 2021).

The failure to tackle some of these design challenges, which impact effective implementation, has led to significant inter-regional disparities and a weak relationship between public spending and its distribution (Mansour, Subramanian, & Canning, 2009; Dreze & Khera, 2012; Berman, Bhawalkar, & Jha, 2017). An analysis by the Economic Survey – 2016-17 of the largest CSS (in terms of budgets) found significant misallocation of resources. In other words, the poorest areas of the country often received a much lower share of government resources than their richer counterparts (Ministry of Finance, Government of India, 2017, p-177).

Recognising the wide intrastate disparity in implementation, the Union government has in recent times focused specifically on the district administration. In January 2018, the Aspirational District Programme (ADP) was launched with the aim of quickly transforming the 112 most under-developed districts across the country. In 2023, a similar Aspirational Block Programme (ABP) has also been announced. These, however, are unlikely to reach their full potential without broader reforms in the PFM cycle. This paper seeks to unpack some of these challenges by looking at the key constraints in India's PFM system following the budget cycle.

Broadly, the budget cycle refers to three phases, namely Budget Formulation, Budget Execution and Budget Evaluation. In simple terms, budget formulation refers to the process through which governments quantitatively express a policy or plan and indicate priorities (Kapur and Shukla, 2021). Budget execution on the other hand refers to the process by which allocated funds are spent. Finally, budget evaluation refers to the process of analysing how effectively funds were accounted for and used.

The paper is structured as follows. Section II briefly describes the structure of India's PFM cycle, including some recent innovations with respect to PFM. This is followed by a look at the challenges that remain following the budget cycle, in section III. Finally, section IV concludes with a few recommendations.

II. Brief Background of India's PFM System

India follows an incremental budgeting system based on specific line items. This means that budgets are made by changing previous years' budgets across Ministries, sectors, schemes or even line items. The line-item wise classification, in turn, is based on a six-tier accounting system using a fifteen-digit numerical code. Expenditure is classified based on its function, programme and economic nature. Receipts are classified according to their nature and source.

At the Union government level, the most important document is the General Financial Rules (GFR) (Ministry of Finance, Government of India, 2017). This document lays out rules to be followed while dealing with public finance matters.

Fund transfers broadly occur through two key mechanisms: The Treasury Route and Society Route. Each of these is briefly described below: -

Treasury Route

The most common fund transfer process is the treasury route, wherein the Reserve Bank of India (RBI) is intimated to transfer funds to state governments. Once a state government and state-level Accountant General (AG) receive clearance from the RBI, the State Finance Department approves the budgetary allocations / withdrawals, and the concerned department / agency withdraws funds.

Expenditure is meant to be tracked till the last level through a system of vouchers for each transaction, available with the AG. The expenditure, as compiled by the AG, goes through a process of validation, and is finally audited by the Comptroller and Auditor General (CAG) of India.

At the subnational level, state and district treasuries form the foundation of the public finance machinery. Administrative control over the treasury (which is generally divided into district treasuries, sub-treasuries, and special treasuries), rests with the Finance Department of the state. The Finance department is supported by a set of gazetted officers, known as Drawing and Disbursing Officers (DDOs), who have authorisation to draw bills and make disbursals on behalf of the government at the local administration level. These DDOs are based in the facilities, various districts, and the state government's headquarters. The significance of district treasuries can be understood by the sheer volume of funds they handle. Analysis conducted by the Accountability Initiative in FY 2014-15 found that in Odisha, district treasuries received nearly Rs. 36,000 crore, which is approximately 54 per cent of the total State budget.

Society Route

The Union government undertakes a significant amount of expenditure on welfare programmes through CSS. In Financial Year 2022-23, for instance, 11 per cent of funds were for CSS. To a large degree, CSSs have their own planning and budgeting system, and at times, their own administrative structures.

In theory, most CSSs call for bottom-up planning, which is meant to start at the village or block or facility level. These are then meant to be aggregated at the district and then the state level, and final approvals are negotiated between the Union and state governments. Funds for the schemes are to be shared between the Union and state governments based on these approved budgets.

Releases by the Union government are meant to be based on these approvals and done in 2-3 instalments. The first instalment is usually an ad hoc grant of up to 25 per cent of the total budget at the start of the financial year. The remaining instalments are based on the submission of Utilisation Certificates (UCs) — a UC is a signed statement by a designated officer detailing the total receipt and expenditure incurred from that amount. Funds are released only after 60-75 per cent of the money transferred till date has been utilised by the State and if the state has contributed its state share[1].

At the state level, for several CSSs, fund transfers from the state to districts is the responsibility of autonomous bodies known as State Implementation Societies (SISs). For instance, for the National Health Mission (NHM), once funds are received by the State treasury, they are transferred to the State Health Society in the state, which, in turn, transfers funds to districts, blocks, and other implementing units such as facilities.

For the purpose of tracking and monitoring Central Sector Schemes (those schemes that are 100 per cent funded by the Union government) and CSS funds, the Union government has implemented the Public Finance Management System (PFMS), a web-based online application. From October 2017, the Government of India (GoI) made it mandatory for the PFMS to be used for all such schemes. The system is meant to simplify expenditure tracking across states. Unfortunately, however, the PFMS is not publicly available.

In 2021, as part of PFM reform, the Finance Minister announced the launch of a Single Nodal Agency (SNA) Dashboard. Under the revised model, each state recognises and designates an SNA for every scheme and thereby all funds for the state in a specific scheme are to be transferred to this bank account. All expenditure is to be incurred from this account by all the relevant Implementing Agencies (IAs).

While these innovations are an important step towards visibility on finances, a few problems remain and have a bearing on the ability of districts and local bodies to implement programmes.

The next section looks at some of these challenges and their implications for the district and sub-district levels

Challenges

First, the nature of India's accounting system is such that there is an inherent opaqueness in data on transfer of funds to the states as well as their utilisation. For instance, the transfer to the states by the Union, and to the implementing agencies by the states is immediately booked as final expenditure regardless of actual utilisation.

The situation is further complicated by the fact that state-wise details of transfers under various functional heads is often not captured. As noted by the Sundarmurthi Committee Report, "Major Heads, which are supposed to represent government functions, do not reflect true functional character of expenditures and do not correspond to Heads of development used in the planning and resource allocation process" (Controller General of Accounts, Ministry of Finance, 2016) As a result, spending within a specific location, such as a district or

1 https://doe.gov.in/sites/default/files/23.03.2021.pdf

panchayat, or spending on specific groups, such as women, scheduled castes or scheduled tribes, cannot easily be captured in the current accounting structure.

The second challenge is the ubiquitous concept of Utilisation Certificates. As previously mentioned, the payment architecture, for the most part, requires funds to be released in instalments. The government will send its first instalment of an allocated sum in a budget to the administrative layer below it. Once the lower administrative level uses up a proportion of the funds, it can provide a document stating so and request the next instalment. As per the GFR 2017 that is in operation (Rules 238-Rules 241), any non-recurrent expenditure should be accompanied with a UC.

The rules mandate that the concerned Ministry or department should release the sanctioned amount for the subsequent financial year only after the UCs for the preceding financial year's grant have been submitted. State governments are also required to submit UCs for grants-in-aid for schemes to the Union Government. These UCs remain mostly manual and thus usually are not machine-readable and do not have much detail on the quality of expenditure.

This brings us to the third challenge, namely, the push system with respect to payments. In the current system, since the subsequent release of funds is based on the state having utilised a portion of its funds, this means that even districts that may have utilised all their funds have to await their turn. Despite budgets being pre-approved (particularly for CSSs, which have an extensive planning process), numerous sanction orders and administrative clearances are sought before funds are released, leading to delays. A study conducted by the Accountability Initiative found that at the state level alone, under the NHM, a file had to pass through 22 desks and there were on average close to 900 sanction letters that were sent for the scheme in FY 2017-18 alone. This also leads to significant delays at the last mile. To cite an example, analysis of the management information system (MIS) of the Pradhan Mantri Awas Yojana – Grameen (PMAY-G) found that despite houses being constructed, cumulatively till 13 January 2023, Rs 1,488 crore was due to be paid in instalments for completed houses (Jacob, Mallick, & Kapur, 2023).

The push system has consequences for the Union government as well. Since funds are released as a lumpsum to officials at various levels in advance of actual expenditure, money often sits in bank accounts until it is ready to be used. This unused money, called "float", has consequences on the cash flow of the Union government, which may need to borrow to finance its requirements. While there has been no recent estimate that is publicly available on the extent of float, the 2015-16 Economic Survey had pegged its value to be close to Rs 1 trillion (Ministry of Finance, GoI, 2016).

These challenges are also evident in the large unspent balances that often remain at different levels. The Union government's CAG reports found Rs. 4.10 lakh crore in unspent balances in 2019-20. For some departments, unspent balances were more than 40 per cent of the sanctioned amount (CAG of India, 2021, Annexure 3.2).

Last, but not the least, weaknesses in the financial MIS and fragmentation of programmes makes it difficult to monitor the use of funds and the services that are being delivered with public money. This is not just true for citizens, but even for the governments at different levels.

But what do these challenges in the design of India's PFM system mean for district-level financing? The next section provides some case studies, which show how the ability of districts and sub-districts to deliver welfare programmes is affected by these challenges.

III. Implications for the Sub-National Level

For districts that do not really have revenue raising capability but are often responsible for implementation, these design challenges can have serious implications on their ability to deliver welfare services.

Let's take the example of the erstwhile Anganwadi Services scheme (now integrated as Saksham Angwandi and Poshan 2.0). As per the erstwhile scheme's guidelines, every Anganwadi Centre (AWC) was entitled to a flexi grant of Rs 1,000 annually to cover small basic needs such as repairing weighing machines or cooking equipment, or buying medicines, stationery, etc.

Yet, delays in the fund flow system meant that often even these small annual grants did not reach the AWC, or did not reach it on time. A process tracking study of the scheme, conducted by the Accountability Initiative in 2018-19 across 6 districts within 3 states, found that on an average, only 60-80 per cent of AWCs had received their grants. In two districts, no funds had been released in January and February. In another district, funds released in 2018-19 were for the previous fiscal year, i.e., 2017-18, indicating an over 1-year delay in receipt of funds. The situation is not unique to this scheme. Several studies have found similar instances of delays across sectors and programmes.

While part of the delay could be due to lack of utilisation, in some ways the system promotes underspending. This is because there is significant unpredictability in fund flows and limited information available to states, districts or local bodies on how much money they ***will*** receive and ***when***. The uncertainty, in turn, breeds caution in incurring expenditure as certain committed funds such as salaries need to be paid on time.

These delays of course have significant implications for the citizens at the last mile. A case in point is the nutrition interventions delivered through numerous ministries and meant to converge at the household level. With different fund flow and administrative mechanisms, the likelihood that citizens have received all the benefits they are entitled to within a year is rare. A study conducted by Menon, et al, (2019) mapping both nutrition-specific and nutrition-sensitive interventions at the household level from villages in Chhattisgarh, Jharkhand, Madhya Pradesh, Odisha and West Bengal, found that on an average, households received only eight out of 13 nutrition-specific interventions and four out of six nutrition-sensitive interventions. In fact, only 23 out of 1,417 households (1.6%) had received all 13 nutrition-specific interventions.

The human cost of these Issues shook the country when in August 2017, 60 children died in a public hospital in Gorakhpur, Uttar Pradesh. Over the course of investigations, it was revealed that the failure of the state to send money to the hospital meant that the institution had failed to make a payment of over Rs 65 lakh to a private company that had supplied it with oxygen for over six months[2].

The next section provides a set of recommendations on what can be done to resolve some of these design issues.

2 https://scroll.in/pulse/847105/adityanaths-visit-to-gorakhpur-proved-deadly-as-oxygen-payments-were-delayed-by-a-day-says-doctor

Recommendations

Reclassification of Heads of Accounts

Several attempts have been made to find an alternative budgetary classification of data, given some of the challenges described above. As early as 2003, an expert group constituted by the GoI, also known as the Lahiri Committee, suggested moving to a "multidimensional classification" structure that would be more computer-friendly and allow for flexible reporting (CAG of India, 2012).

Similarly, in 2012, another expert group, known as the Sundarmurthi Committee, had proposed moving from a two-dimensional structure to a multi-segment structure by rationalising and reorganising information into seven mutually exclusive segments with their own individual hierarchical structures. These were: a) Administrative Segment: to identify the administrative responsibility for expenditure; b) Function Segment: to classify the functions of government; c) Programme-cum Scheme Segment: to classify all programmes and non-plan schemes/ sub-schemes; d) Recipient Segment: to recognise external agencies and entities that are recipients of public funds as instruments and channels of public policy delivery; e) Target Segment: to identify expenditure targeted at special policy objectives such as women centric, SC, ST, BPL objectives etc; f) Economic Segment: to capture the economic nature of expenditure along the lines prescribed by the International Monetary Fund (IMF) GFS Manual – 2001, and finally, g) Geographical Segment: to identify the physical location of the transition (Controller General of India, 2012).

It was felt that this classification would allow for easier presentation and allow for disaggregation of information in multiple ways. Thus, while the administrative classification would strengthen the accountability for public spending by attributing each budget line to an administrative authority, the functional classification could be used as a very effective tool for macro-level planning and sectoral analysis, including outcome budgeting. Similarly, the budgets and expenditure on different geographical divisions, such as states, districts, and towns/villages, as well as on different beneficiaries or target groups could easily be identified.

Given the increasing push towards better planning, strengthening resource utilisation, effective monitoring, and decision-making processes, a review of the current classification system could go a long way in ensuring greater accountability and analysis of budgets and their utilisation.

In the short term, given that most states have computerised treasury systems, a unique code could be institutionalised to capture location details of all expenditure — for instance, at the Gram Panchayat level, district level, block level and so on. This would enable consolidation of expenditure data across various entities within a geographical area of a habitation and give more visibility to subnational expenditure, which would be useful for planning and prioritisation.

Moving towards a pull system

It is important to move away from the current system of sanctioning and pushing money to lower levels and waiting for UCs before releasing further instalments to a more real-time system that allows all entities to automatically draw money when required within a pre-defined budget envelope. This has often been described as a 'just-in time' system. In fact, during the launch of mandatory use of PFMS for all CSSs, former Union Minister Arun Jaitley had spoken about the tremendous potential of PFMS to "the float in the financial systems by enabling 'just in time' releases"[3]. If implemented well, this would remove the need for having DDOs to disburse funds.

3 https://pib.gov.in/PressReleasePage.aspx?PRID=1511427

In simple terms, this is akin to an auto debit within a Unified Payments Interface (UPI). People put a maximum limit on how much can be withdrawn but when a mandate is received, an alert comes, and funds are transferred instantaneously. Every line item in the budget has an associated resource envelope and spending above that requires additional sanctions from Parliament. Thus, as long as the demand is within the limit, there is no reason why funds need to go through the long, arduous process of sanction, review, approval and then release. This would also reduce the administrative burden of having to push files through the system and remove delays and bottlenecks at the last mile.

With the mandatory introduction of SNA accounts for all CSs and CSSs, the first steps in creating an integrated banking system have already been achieved.

Computerisation and Public Access to Treasuries

Over the years, there have been a number of policy initiatives for e-governance in treasuries. Starting with the recommendations of the Sixth Finance Commission (1974-79) which called for the *"Upgradation of Standards of Administration"*, a number of successive Finance Commissions provided grants related to infrastructure development and treasury upgradation. An explicit grant for the computerisation and automation of treasuries in various states was made by the Tenth Finance Commission (1995-2000). As the Tenth Finance Commission noted, *"the computerisation of district treasuries would go a long way in improving the managerial control of both the state and district level administration. It would also make for speedy and accurate generation of accounting information that might be needed for purposes of better planning, budgeting, and monitoring"* (Finance Commission of India, 1995).

This was followed by the Thirteenth Finance Commission, which led to a mission mode project for computerisation of state treasuries with an allocation of Rs 625 crore to bring in transparency and enhance the efficiency of the public service delivery system. The scheme was supposed to be implemented in about three years beginning from the 2010-11 fiscal year, with a view to support States and Union Territories in filling gaps in their treasury computerisation, upgradation, expansion, and interface requirements, apart from supporting them with basic computerisation facilities. The treasury computerisation project was expected to make budgeting processes more efficient, improve cash flow management, promote real-time reconciliation of accounts, strengthen MIS, ensure accuracy and timeliness in accounts preparation, bring about transparency and efficiency in public delivery systems, improve financial management, and above all, make this information available in the public domain to strengthen public oversight and participation.

While some states have made significant progress in computerisation of treasuries, many still do not have publicly accessible treasuries. In order to ensure increased transparency and accountability through civic engagement, targeted efforts to ensure public accessibility of treasuries is important.

Strengthening Citizen Access to Budgets

Related to that is the need to strengthen citizen access to budgets. In India, the government cannot spend or raise public money without the authorisation of Parliament. This, in principle, preserves the people's right to know where public funds are being allocated through their elected representatives. A participatory public budget is also a good measure of transparency. Public financial management is strengthened if the participation of the public in the decision-making process is maximised.

Yet, currently, getting disaggregated data at the district level is difficult. In keeping with the government's commitment of improving transparency and Section 4 (2) of the Right to Information Act (RTI), proactive disclosure of real-time, disaggregated information on planning, budgeting, fund flow and implementation of schemes across levels would enable stronger data analysis. For CSSs, the architecture for disaggregated data is available through the scheme MISs, PFMS and SNA reforms.

Data Standards and Accessibility

Last but not the least, in recent years, there have been some civil society initiatives (such as Open Budgets India) that try and simplify complex budget data in easy-to-understand formats. The organisations behind such initiatives need to continue these efforts and work alongside the government to make data more open and accessible.

IV. Conclusion

A transparent, accountable, and closely audited system is critical to ensure optimal allocation and utilisation of resources and distributional equity. This is particularly true in resource-constrained countries such as India, which struggle with income inequality and large regional disparities in access to basic resources. As described above, PFM in India still has several limitations, which, when coupled with weak state capacity, makes it difficult to deliver welfare services. In order to leverage initiatives and harness technology to devolve more funds to local bodies and develop district and block capabilities for provision of welfare services, having a stronger PFM system down to the last mile is critical.

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OpenBudgetsIndia

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OBI is a comprehensive and user-friendly open data portal that facilitates free, easy and timely access to fiscal information. It provides budget information for different tiers of government in India in accessible and open (non-proprietary) formats. Please visit the portal at: www.openbudgetsindia.org

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