

Efficient Public Expenditure Management is the Key to Improved Outcomes



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Rising Government expenditure at a time when focus is on fiscal consolidation, providing increased resources to solve some of India's problems of education and health, becomes challenging. When budgetary allocations are small and there are competing demands from other sectors of the economy, it is imperative that efficiency of expenditure is increased. Research shows that efficiency of the public expenditure depends upon budgetary and non-budgetary factors. Focus on outcomes, links between policy planning and budgeting are vital apart from a medium term fiscal assurance. Those apart, performance management, HR policies and stakeholder engagement are crucial to efficiency of public expenditure.

Keywords: Public Expenditure Management, Efficiency, Outcomes

1. Introduction

Government of India's expenditure has been increasing over the decades. At this time, when there is focus on fiscal consolidation, providing increased resources to solve some of India's chronic problems of poverty, literacy, health, becomes challenging. However, given the policy thrust on inclusive development and growing global focus on sustainable development, many flagship programmes for expediting universalization of education and increasing access to healthcare to improve health indicators have been strengthened and intensified. As development is possible only in a peaceful environment, India is required to continually invest a significant amount of resources to maintain a credible Defence set up, given the sensitive security environment.

Health, Defence and Education take about one, two and three percent of India's GDP respectively. Having faced number of wars with Pakistan, and low intensity conflicts, India faces challenges to national security which require her to pay continual attention to defence preparedness. At the same time, she strives to provide education and affordable, quality health care to her 1.2 billion people. Several committees have acknowledged that to build a credible sustainable defence India requires about 3 percent of GDP for defence. For health, India needs to spend about 3 percent and education 6 percent. Evidently, India spends much lower than the desired amount on the three segments given the scale and magnitude of India's complexity and challenges.

Given the fact that budgetary allocations are small and there are competing demands from other sectors of the economy, it is imperative that efficiency of the public expenditure management system is increased. The following sections unpack the issues which affect the efficiency of the public expenditure management system in the Indian context.

Objectives of Public Expenditure Management System

A public expenditure management (PEM) system is defined as the system of allocation and use of resources responsively, efficiently and effectively and has the following three prime objectives:

First, to maintain aggregate fiscal discipline which pertains to maintaining effective control on budget totals, setting ceilings on aggregate totals and individual totals. Second, to allocate resources aligned with Government's priorities. This refers to government's capacity to establish priorities within the budget and distribute resources as per priorities and program effectiveness and shift resources from old priorities to new or from less productive programmes to more productive. Third is to promote efficient delivery of services which informs capacity to implement programmes and deliver services at lowest cost. (OECD, 2006)

For achieving the desired outcomes, it is essential that the public expenditure management system functions well at all the three levels. The allocation of resources is a function of priorities of the government and often determined by political forces. For instance it has been said in many standing committee of defence have said that three percent of GDP is required to maintain a credible defence of the nation (Lok Sabha, 2012) but having stayed at about two percent, this figure has been declining and is 1.75 percent of GDP in 2015-16. Similarly, public spending on health is barely one percent and education is just about three percent of GDP whereas most emerging economies spend about three percent on health and six percent on education. (Nine is Mine, 2015) Nine percent is the gold standard for education and health combined. Therefore, at the allocation level- the various competing demands of the economy come into play as also it is vulnerable to interests of different political constituencies.

While at an aggregate level, sustainability is a key determinant, allocative and operational level efficiency are sector specific and within the realm of organizations implementing programmes. They are also important as it is very much possible to poorly implement a well formulated budget but it is not possible to execute a poorly formulated budget well. (Allen R, 2001) As it is the implementation issues which determine the outcomes, this paper explores the aspects of operational

efficiency with specific context of some developmental programs and defence financial management activities. The author draws upon some features of the public expenditure management systems in some of the developed and emerging economies to drive home the key differences and aspects which can be learned and adapted to the Indian system of public expenditure management.

Components of a Public Expenditure Management System

As commonly understood, a system of allocation and utilization of resources- i.e. a budgetary system is at the core of the public expenditure management system. Yet it is only one of the elements for an effective management of public expenditure. Success of a budget depends on its implementation and therefore not just the budgetary management system but several others outside it. Sound policy and good analysis are not enough to ensure results and sustainable development outcomes. The institutional arrangements, both formal and informal must demand good performance to achieve intended results. A good public expenditure management system, therefore, requires focus on performance, links between policy making, planning and budgeting, well-functioning accounting and financial management systems and Attention to the links between budgeting and financial management systems and other service-wide systems and processes of government for decision making. (World Bank, 1998)

2. India's Budget Process

In India, Budget is prepared on annual basis. Rule of lapse applies as all appropriations expire at the close of the financial year. The budget formulation process for the ensuing financial year (April-March) starts in the month of September of the current year. The Budget Division in the Department of Economic Affairs, Ministry of Finance, issues a 'Budget Circular' seeking statement of budget estimates from the various Ministries and other estimates from the various Ministries and other organizations concerned in specified proformas. The estimates include actual expenditure for the past year, estimates for the current year, revised estimates for the current year and budget estimates for the budget year. Towards the close of the financial year (December- January) timeframe, supplementary grants are announced to take care of unmet demands or additional requirements and to re-appropriate from those line items where expenditure has progressed slowly and it appears the spending departments or agencies will not be able to spend the allocated funds.

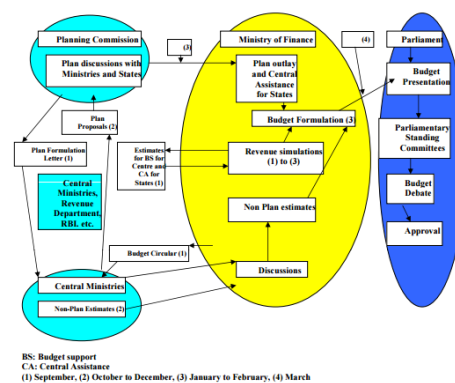


Figure 2 Overview of Budgetary Process

Source: CAG (Comptroller and Auditor General)

3. Classification of Plan and Non-Plan Expenditure

The budget is divided primarily into plan expenditure and non-plan expenditure. Plan expenditure refers to expenditure which is incurred on items included in the five year plan and is normally incurred on development works. Non Plan expenditure refers to expenditure outside the purview of the Planning commission and includes big ticket items like Defence budget. Though the origins of the distinction between plan and non-plan are unclear, some authors have surmised that this distinction arose due to the early planners' acknowledgement of the fact that they did not understand Defence requirements and did not want to be held responsible for inadequate allocations or delays which might have impacted Defence preparedness. This particularly was in the wake of Pakistan's armed aggression immediately after independence in 1947. (Subrahmanyam, 1973) This distinction has led to keeping Defence out of planning process in India and outside the strategic objectives of the nation and lack of a medium term planning horizon. (Malik, et al., 2007) Ministry of defence is by and large on its own to define its own requirements final allocations being decided by the Ministry of Finance (Ghosh, 2006) (Sivasubramanian, 2006)

A committee led by Prime Minister's Economic Advisory Council chairman has recommended a complete overhaul of the country's public expenditure management and has even mooted doing away with the classification of expenditure as Plan and non-Plan, which does not always convey the productivity of spending. "On the removal of Plan and non-Plan classification, there will be a fundamental shift in the approach of public expenditure management from the segmented view to a holistic view of expenditure, from input-based budgeting to the budgeting linked to outputs and outcomes" (The Financial Express, 2011). This review becomes even more pertinent after the winding up of the Planning Commission which in its new avatar is called the Niti Aayog and unlike the body which oversaw plan formulation and implementation is a policy think tank-

intended to provide a critical directional and strategic input to the development process apart from being the incubator of ideas for development. (Cabinet Secretariat, 2015)

Links between Policy, Planning and Budgeting

As explained in the preceding section, the budgetary provisions can be changed during the course of the year, to some extent. While the budgetary process does require explanatory notes to any changes sought at various stages of the budgetary process, budget constraints are not hard as there is a possibility of both-either getting more funds during the currency of the year or surrendering funds. Though the union budget is intent of the government and outlines priorities of the government, at department or agency level there is no requirement of the budget to be supported by clear strategy and explicit statement of priorities.

The system also encourages unproductive spending as inability to spend during a financial year not only leads to lapse of funds to the government; it also has an impact on next years' funding; lesser the spending, lesser the allocations next year. Therefore government sees a massive surge of expenditure in the last quarter of the financial year. Despite many steps to urge organizations to spend evenly during the year, most expenditure tends to get bunched up in the last quarter as implementing organizations do not want to surrender allocated funds. (Ministry of Finance, 2015) This leads to pernicious practice of parking funds with Public Sector Undertakings (Comptroller and Auditor General, 2014) (Business Standard, 2014) or expenditure on office equipment which can be procured using rate contracts or other non-productive, non-operational expenditure which does not require to go through long winding procurement process. (Misra, 2015)

Ministry of Defence continues to surrender funds under the capital budget because it is unable to spend the allocated funds due to long winding capital acquisition process. (Behera, 2009) (Misra, 2015) While the Ministry of Defence has put in place a dedicated acquisition structure for capital acquisitions, it continues to be mired by the problem of being fragmented with diffused accountability and without any frameworks to measure performance, in the absence of which, while, the budget on capital acquisitions gets surrendered, armed forces continue with some critical gaps in operational preparedness. (Ministry of Defence, 2012)

The Defence Procurement Procedure, the key policy document and procedure for defence acquisition seeks to link the procurement process to the planning process by prescribing formulation of the fifteen year Long-Term Integrated Perspective Plan (LTIPP) which outlines the technology perspective and the capability road map, formulation of the five year Services Capital Acquisition Plan (SCAP) which indicates the list of equipment to be acquired, keeping in view operational requirements and the overall requirement of funds and a short term Annual Acquisition Plan (AAP) of each service which is a two year roll on plan for capital acquisitions and consists of the schemes from approved SCAP. Defence planning, although commences with the LTIPP, it does not derive strength from any publically known national plan which articulates how national defence fits into the national objectives and how the latter would drive the former. This is reflected also by the fact that defence has been kept out of nation's planned development efforts and allocation of resources for defence is considered in isolation from allocation for other priority areas. (Ghosh, 2006)

The Planning Programming Budgeting System (PPBS) adopted by the USA in the 1960s has already shown how the planning process determines military objectives and force requirements and programming phase translates the objectives into time phased programs and budgeting phase translates program requirements into resource requirements of spending departments. PPBS was further improved to include the execution element and is formally known as Planning Programming, Budgeting and Executive (PPBE) system since 2003. PPBE and the Defence Acquisition System are connected through DoD's personnel and financial resources. At program initiation, an acquisition program must identify its needs for these resources over the life of the program. These requirements have to be consistent with the resources that have been allocated to the program in the latest PPBE cycle to ensure that the program is affordable. As the program is carried out, its budget requirements are updated and changes reflected in the PPBE. The acquisition system driven by DOD 5000 in turn emphasizes establishment of program goals— thresholds and objectives—for the minimum number of cost, schedule, and performance parameters that describe the program over its life cycle. The program goals in turn have to be linked to the DoD Strategic Plan and other appropriate subordinate strategic plans, such as component and Functional Strategic Plans and the Strategic Information Resources Management Plan. (DOD12)

From Indian perspective, the most useful elements of the American PPBE system are evolving a military strategy out of a national security strategy which translates into military programs, provision of assured resources over medium term and now a focus on execution. The system also benefits from active engagement of the top leadership like the Secretary of Defence and Joint Chiefs of Staff.

United Kingdom too prepares a four year Defence Plan which delivers its defence strategy, reflects priorities and how strategic objectives will be delivered. It outlines sub strategies for the Armed Forces, Capability, Acquisition, Workforce, Security Policy and Financial Management among others. Owners of each of these in turn define their own priorities and strategic, resource aware long term outlook with specific details for the first 4-5 years. ()

Focus on Outcomes- International Experience

There are some excellent examples of focus on outcomes in the social sector which has improved service delivery, and sharpened the effectiveness of public expenditure which can be evidenced in the programmes such as the National Health Service of the United Kingdom and education programme in Chile.

United Kingdom made Public service agreements as one of the major innovations in public expenditure planning. As the public sector is not subjected to competitive pressures of the private sector, it has been intended to subject it to the pressure of accountability through PSAs. van den Noord, 2002) The Public Service Agreement for each department includes a single aim and a number of objectives, which set out the aspirations of the department, and for each objective outcome-focused target against which progress can be measured.

Chile has used a variety of tools to improve its education outcomes- including increased autonomy with the local government, voucher based financing, and focus on performance assessment and compulsory schooling up to grade twelve. In about fourteen years Chile's education outcomes have improved markedly with enrolment rates for upper secondary going up to 70 percent, graduation rates improving to 67 percent and dropout rates falling to 4.5 percent. (Moccerro, 2008)

4. Financial MIS, Outcome Reporting and Audits

Requirements to report results too can improve outcomes. In India most MIS furnished by implementing agencies and departments to their administrative ministry is expenditure against allocation. When funds are given by departments and agencies to other network agencies like state governments or NGOs, they seek only Utilization certificates which certify that funds have been utilized during the period of report. While in India, budget process is essentially, input budgeting, many countries like the United Kingdom moved away from the system they bequeathed to India, about 65 years ago and they rely on programme budgeting. United States of America too has a complex budgeting system which has close connect with planning and programmes.

Although India has comprehensive accounting and auditing standards, adequacy of accounting standards is worth examining. The government departments follow cash accounting and report expenditure after it is incurred. Accrual system of accounting has long been discussed but is far from implementation. (Misra, 2015)

Comptroller and Auditor General (CAG), the supreme audit authority and conducts periodical audit of all government departments, public sector undertakings and state governments and implementing agencies. Some of the larger departments like Defence have their own internal audit wing as well. While the CAG carries out performance audit apart from regulatory audit, focus of most internal audit organizations is compliance audit and not oriented towards the efficiency or effectiveness audit.

5. Strategic Planning

To make PEM efficient for resource allocation decisions, it is necessary to link resource allocation with vision for the organization and agency, at micro level and for state and country at a macro level. From the vision and mission of the organization, its measurable objectives can be identified. Providing funds for activities which are aligned to the stated vision is more likely to achieve results. The second factor for success of resource allocation is affordability. There must be a forum where resource availability is discussed along with tight links between policy making, planning and budgeting. Information on cost of existing policies over medium term and outcome information of new policy proposals is essential to robust decisions on resource allocations even if they are driven by political considerations and perceptions of the elected leader of the requirements of the constituents (Kelly, et al., 2011).

For coherent system of defence resource management, national security objectives need to be defined and defence policy articulated to balance defence effort with other national objectives and priorities such as maintaining a viable economy and supporting development of the society. Former Chief of Army Staff General VP Malik has written that "*lack of cohesive national security strategy and defence policy has resulted in inadequate political direction regarding politico military objectives.*" (Malik, et al., 2007 pp. 188,195) Much earlier, Subrahmanyam had opined that lack of clarity in thinking regarding the place of defence in planned development stands in the way of India's developing adequate defence capacity to defend itself. (Subrahmanyam, 1973)

Brazil, an emerging economy which has growing focus on defence, in its National Defence Strategy of categorically expressed that its Defence strategy will be inseparable from Brazil's development strategy and the latter will in fact drive it. Based on the National Strategy of Defense (NSD) and its resulting Military Strategy, the Armed Forces are required to submit their Equipment and Organization Plans. The Plans of each service then, need to make reference to short-term, medium-term and long-term goals. (Ministry of Defense, Brazil, 2008)The NSD addresses Defence holistically from outlining the vision to meet its security requirements, power projection for geopolitical aspirations and articulates its manpower strategy, building technological and production capability, engaging civil society. (Moreira, 2011)

Canada, another relatively smaller defence spender who has struggled with slow defence procurement came out with Canada First Defence Strategy in a bid to prepare a modern military ready for twenty first century. (2008)

Institutional Arrangements

For achieving operational efficiency there are many arrangements which lie outside the budgetary system, particularly in the way, the organization is set up. Resources and systems support should be commensurate with responsibilities. There must be clarity of purpose in terms of outcomes to be achieved and clarity of tasks in terms of outputs to be produced. Organizations must also have an adequate mix of authority and flexibility to pursue purpose and undertake the tasks and finally there has to be accountability for use of authority.

Factors like clear objectives and tasks, merit based personnel policies, ex ante performance specification, performance information, evaluation, transparency, accountability, competition, voice and flexibility in management of non-financial resources hold key to effective operational efficiency (OECD, 2006). In India clearly there are variances from this gold standard of organizational setup. Seniority is the most important criterion for promotions within civil service in India. (G Connect, 2011) Incentives and reward system is not linked to performance.

A shining example of enabling institutional arrangements can be found in the Bolsa Familia programme of Brazil. It is one of the largest conditional cash transfer (CCT) programs in the world, benefiting roughly 11 million families. Like most CCT programs in Latin America, Bolsa Família provides a conditional monthly transfer to poor households—those which earn less than R\$120 (US\$68) per capita per month- with children up to seventeen years of age and/or a pregnant woman with up to a maximum of three children. It also provides a monthly transfer to extremely poor households which earn less than R\$60 (US\$34) per capita—regardless of their composition. For extremely poor childless households, there are no conditions attached to the transfer.

The program started in 2003 with the merger of four existing conditional and unconditional cash transfer programs of the federal government: Bolsa Escola, a minimum-income grant related to primary education; Fome Zero and Bolsa Alimentação, income grants related to food security, the former unconditional and the latter conditional on health checkups and immunization updates; and Vale Gás, a subsidy to help poor households buy cooking gas. By the end of 2006, Bolsa Família had been scaled up to include 11 million households.

Bolsa Família's most distinctive features are the use of self-declared income instead of a proxy means method to assess eligibility; the existence of an unconditional transfer to extremely poor households regardless of the presence of children or pregnant women; and the decentralized nature of the application process and monitoring of conditionalities. (Fabio Veras Soares, 2010)

Responsiveness of a Procurement System

There is a need to set up a system which engenders and encourages responsiveness instead of just conformity to procedures which although encourage standardization and non-partisan ship, can never fully address all situations and can delay decisions having significant cost and security implications in medium to long term. The procurement structures have to reflect accountability instead of dispersing it and have to be vested with the authority and flexibility to take a decision aligned with stated objectives and outcomes.

Features of flexibility, responsiveness and being outcome focused are hallmark of all well performing defence procurement systems around the world. The stated vision of Federal Acquisition System established by the United States of America is to *“deliver on a timely basis the best value product or service to the customer, while maintaining the public's trust and fulfilling public policy objectives. Participants in the acquisition process should work together as a team and should be empowered to make decisions within their area of responsibility”*. (DOD12)

6. Competition

By and large there is little competition to government agencies and departments and even the public sector undertakings either enjoy monopoly or work in monopsony situations. For example, the ordnance factories and public sector undertakings supplying weapons and equipment to defence like the tanks, guns, aircrafts and their spare parts enjoy monopolistic situation where these organizations have been set up to supply to defence and defence is their sole customer.—monopsony. Thus both the buyer and seller are captive to each other. Organizational inefficiencies and lack of accountability have led to India continuing to rely on imports for about 70 percent of their weapon equipment. Former Chief of Army Staff Gen VP Malik (Retd), DRDO must be accountable for faster and timely development of weapon systems. There is a growing realization, that encouraging private Industry to participate in defence activities is vital to greater self-reliance. (David, 2015) Engendering competition by creating a level playing field for can be one of the most powerful policy instruments for tackling market failures arising out of monopolistic and monopsonic situations. The Make procedure and the new defence procurement procedure is therefore, the most keenly awaited document. (Kulkarni, 2015)

Section of approach paper to twelfth plan on Governance and empowerment makes a telling commentary on how well the system is geared for outcomes. It states, *“programmes and schemes are often designed without adequate understanding of the desires and limitations of the beneficiaries, especially the most disadvantaged; (ii) systems for informing the people of their rights and entitlements are very poor and often exclusionary; (iii) the service delivery personnel, apart from issues of corruption, are inadequately informed of their duties and responsibilities and take little pride in their work; and (iv) complaint redressal systems are not independent of the delivery mechanism resulting in non-responsive behavior”* (Planning Commission, 2011). This ties into our discussion on institutional arrangements contributing to operational efficiency and achievement of outcomes.

Performance Indicators

Performance indicators can play an important role in improving outcomes (IMF, 1997). Sweden requires all ministries and agencies to include performance indicators in their annual report, along with the financial statements. In Finland, significant financial devolution to agencies has been accompanied by a requirement that performance indicators be developed both for inclusion in an annual report and as part of “results oriented budgeting.” The UK approach stresses annual performance agreements between ministers and the chief executives of agencies. In New Zealand, performance information plays an

important role in resource allocation decisions in the annual budget process. Most budget allocations in New Zealand are based on a purchase agreement between the minister and the chief executive of each ministry or agency. The agreement covers the provision of an agreed type, volume, timing, quality, and cost of outputs in return for the specified appropriation. The budget review system provides for a review of why actual outputs may have differed from that specified in the agreement. (OECD, 2006)

7. Social Indicators of Development

The socioeconomic and health indicators indicate progress achieved by India in its six decade planned development journey. The ones, frequently used are: per capita income, poverty, Literacy, IMR, MMR, TFR, Disease incidence. The Human Development Report (HDR) published by the United Nations Development Programme (UNDP) estimates the human development index (HDI) in terms of three basic parameters: to live a long and healthy life, to be educated and knowledgeable, and to enjoy a decent economic standard of living. According to HDR 2013, India with an HDI of 0.554 in 2012 has slipped down a few notches with its overall global ranking at 136 (out of the 186 countries) as against 134 (out of 187 countries) as per HDR 2012. (Ministry of Finance, 2014)

Although India's per capita income has increased from Rs 3,744 (at constant prices base 1993-94= 100) in 1950-51 to 10,207 in 1999-2000 (Planning Commission, 2000), India was 169th in terms of per capita income in the world in terms of purchasing power parity (PPP), the country's per capita income grew to \$5,833 in 2014. (2015) Despite running world's largest poverty alleviation program like National Rural Employment Guarantee program and a continued focus on poverty alleviation through programs like National Food for Work Programme, Integrated Rural Development Programme, Jawahar Rozgar Yojana, National Rural Employment Guarantee Programme and several other schemes, India is just about becoming a middle income country. (Planning Commission)

8. Concluding Thoughts

After six decades of developmental effort, India continues to be a low- middle income developing country beset with problems of poverty, limited access to affordable quality healthcare by majority population despite improvements in infrastructure and basic industries, breakthroughs in agriculture- increased availability of food grains, relatively high growth during the last two decades, improvements in health care and diversification of economic activity. There is a growing realization that public programmes have to become outcome focused and the results achieved by incurring public expenditure must improve to improve outcomes in all spheres of governance. The Finance Minister in his speech for the 2014-15 budget had stated "The time has come to review the allocative and operational efficiencies of government expenditure to achieve maximum output". This was followed up with the formation of the Expenditure Management Commission in 2014. The Commission has since submitted its interim report which focuses on three broad areas - Delivery of schemes, Use of Technology and Accounting Methods. (2015)

For improved outcomes, it is essential to provide links between policy, planning and budgeting, simplify procedures, provide flexibility at the implementation level to enable achievement of well-defined outcomes and define outcomes for each programme and organization and for achievement of those measurable targets- by defining process or output indicators. As HR practices have significant impact on outcomes, it is important to link tenure, promotion and rewards of senior managers to achievement of results, take action against individuals involved in issues pointed out by audit and build capacity among the human resource- be it doctors, nurses, paramedical staff, teachers or acquisition professionals. Simplification of procurement system and strengthening of programme management by using rigorous reviews, feedback mechanisms like client surveys and stakeholder engagement are the other key measures for an efficient public expenditure management system and achieving improved outcomes.

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