

**THE INDIAN FINAN-
CIAL SYSTEM**
O. K. GHOSH

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By

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PREFACE

The subject matter of this book is the financial system of India, with special reference to the requirements of our growing democracy. The book is not merely descriptive. In fact, I have tried more to analyse than to describe. The basic idea is to review our financial system and to make suggestions as to how it may be better geared to the needs of our new democracy.

This book is addressed to many types of readers. There is, I hope, enough descriptive material to give factual knowledge to college students and also enough analysis to provoke some of them to thinking. I have always kept the needs of democracy, both in the larger sense of public welfare, and in the more limited sense of rule by the people, in mind, in each of the chapters. I hope, therefore, that the book will find favour with those legislators and members of the general public who are interested in financial matters. And finally, I hope that administrators will not disdain to glance through these pages, although the tradition which we have inherited from our erstwhile rulers in India in the administrative sphere is primarily non-intellectual, if not anti-intellectual. I hope also that people outside India and especially those in "underdeveloped" countries will find this book of interest and perhaps of some use. The problems which we face are faced by some other countries as well.

The chapter heads will show that various aspects of financial administration have been dealt with—relation between the Centre and the States, budgetary methods, expenditure control, audit and planning.

In the Indian bureaucracy, my experience has perhaps been somewhat unique in financial, economic and planning matters in the sense that I have seen the Government machinery at work from different angles. I have been in an audit and accounts office, first in a junior capacity and then as Accountant General. But two-thirds of my 16 years of service have been spent outside the audit and accounts department. These years have been spent as a Government

of India Secretariat drudge (Under Secretary and Deputy Secretary) in the Department of Revenue and Expenditure, the Department of Economic Affairs, the Planning Commission, and the States Reorganisation Commission. I have also made a study of the relations between the Federal and State Governments in economic and fiscal fields in Canada and the U.S.A. I hope, therefore, I have been able to see the various problems dealt with in this book from many aspects.

In writing this book there have been two value premises. Firstly, that a system of Government, including the system of financial administration, needs constant review. And secondly, that the best method of review would be by discussion and the meeting of minds of as many informed people as possible, and not by fiat. Those who do not believe in these value premises will not feel the necessity for this book.

I am solely responsible in my personal capacity for the views and suggestions contained in this book. For those which are practicable and acceptable, I wish to express my gratitude to many officials, both senior and junior to me, from whom I have learnt, either consciously or unconsciously, many things. The faults, deficiencies and errors are all wholly mine. Naturally I am not conscious of them. If any one reading these pages is kind enough to point them out to me, I will do my best to rectify them, if such an occasion occurs in the future.

O. K. Ghosh

Dated 21st Nov. 1957.
Allahabad.

INTRODUCTORY

Here I seek to set out the ground plan of this book.

I first deal with the distribution of financial powers between the Centre and the States. The question of loans and grants to States from the Centre might form part of this chapter. But, logically, the question of loans and grants to States from the Centre is a separate subject matter, although connected with the question of distribution of financial powers between the various units and the Centre in a federation. I have, therefore, dealt with the matter in a separate chapter. This is followed by three chapters on the budget, one on budgetary classification, another on the lapsing of budgetary grants and the third on the Plans and the budget. Then follow two chapters, one on expenditure control and the other on the delegation of financial powers. Then follow five chapters on audit and evaluation, dealing with matters like the necessity of audit, the audit of public corporations, the Public Accounts Committees and the Development State, and personnel for finance, accounts and audit work. Next is a chapter on short-term and long-term financial planning. Then there is a chapter on financial problems and the public. Finally, before the concluding chapter, there is a chapter on certain proposals made by Mr. A. K. Chanda, the Comptroller and Auditor General of India. I would have liked to have included a chapter on the criticisms and proposals of Dr. Appleby. But these have not been officially released in their entirety, and hence I desist from dealing with them. I have had recourse only to published documents (apart from my experience) in this study.

My method, in general, is first of all to set out the problems. Thereafter, I give brief descriptive accounts of the position in India and in some foreign countries. I have drawn largely on the experience of the United Kingdom, U.S.A., Canada, Australia and the U.S.S.R. Each country must work out its own system. But there is no reason why a country cannot borrow good things from other countries,

with necessary modifications. As the famous anthropologist, Ruth Benedict, has said in her book "Patterns of Culture" man is not limited by his biological inheritance to certain types of institutions only.¹

In some places I have had recourse to what might be called models. In this, I have borrowed from the "science" of economics. In economics certain basic conditions are given and a model constructed. Then the question as to what would happen to the given model when it is subjected to different forces is analysed. Such thinking, although abstract, renders the conclusions, if they are correct, of wide general application. Because of this treatment, I hope that this book might also be of interest to people outside India, especially in the "underdeveloped" countries.

¹ Ruth Benedict, *Patterns of Culture* (Mentor Books, New York, 1953), pp. 12-13.

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SECTION I
RELATIONS BETWEEN THE CENTRE
AND THE STATES

CHAPTER I

DISTRIBUTION OF FINANCIAL POWERS BETWEEN THE CENTRE AND THE STATES

One may ask, does democracy come into the picture when the discussion is on the distribution of financial powers between the Centre and the States? This depends on what we mean by the word democracy. This word has travelled far from its original connotation of rule by the people, and now means many things. There is, for instance, the democratic way of life, the democratic approach, the democratic man and so on. As between different organisations like a Central Government and the States in a Federation, democracy may mean the fair distribution of powers between these units and the existence both of machinery for free and equal discussion and for the periodical assessment of the powers of these units, so as to bring them always in line with the needs of the day. It is in this sense that the word democracy is used in this chapter.

How far do various federations, including India, fulfil the needs of democracy, so understood? And if there are any lacunae in India, how can they be bettered?

U.S.A. The basic position was laid down in Article I of the American Constitution, Sections 8, 9 and 10. For facility, I reproduce below Sections 8, 9 and 10 of this article.

Section 8. The Congress shall have power to lay and collect taxes, duties, imposts and excise, to pay the debts and provide for the common defence and the general welfare of the United States; but all duties, imposts and excise shall be uniform throughout the United States;

To borrow money on the credit of the United States;

To regulate commerce with foreign nations, and among the several States, and with the Indian tribes;

To establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States;

To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures;

To provide for the punishment of counterfeiting the securities and current coin of the United States;

To establish post offices and post roads;

To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries;

To constitute tribunals inferior to the Supreme Court;

To define and punish piracies and felonies committed on the high seas, and offences against the law of nations;

To declare war, grant letters of marque and reprisal, and make rules concerning captures on land and water;

To raise and support armies, but no appropriation of money to that use shall be for a longer term than two years;

To provide and maintain a Navy;

To make rules for the government and regulation of the land and naval forces;

To provide for calling for the militia to execute the laws of the Union, suppress insurrections and repel invasions;

To provide for organizing, arming, and disciplining the militia, and for governing such part of them as may be employed in the service of the United States, reserving to the States respectively, the appointment of the officers, and the authority of training the militia according to the discipline prescribed by Congress;

To exercise exclusive legislation in all cases whatsoever, over such district (not exceeding ten miles square) as may, by cession of particular States and the acceptance of Congress, become the seat of the Government of the United States and to exercise like authority over all places purchased by the consent of the legislature of the State in which the same shall be, for the

erection of forts, magazines, arsenals, dockyards, and other needful buildings; and

To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the Government of the United States, or in any department or officer thereof.

Section 9. The migration or importation of such persons as any of the States now existing shall think proper to admit, shall not be prohibited by the Congress prior to the year one thousand eight hundred and eight, but a tax or duty may be imposed on such importation, not exceeding ten dollars for each person.

The privilege of the writ of habeas corpus shall not be suspended, unless when in case of rebellion or invasion the public safety may require it.

No bill of attainder or *ex post facto* law shall be passed.

No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken.

No tax or duty shall be laid on articles exported from any State.

No preference shall be given by any regulation of commerce of revenue to the ports of one State over those of another; nor shall vessels bound to, or from one State, be obliged to enter, clear, or pay duties in another.

No money shall be drawn from the Treasury, but in consequence of appropriations made by law; and a regular statement and account of the receipts and expenditure of all public money shall be published from time to time.

No title of nobility shall be granted by the United States. And no person holding any office of profit or trust under them, shall, without the consent of the Congress, accept any present, emolument, office, or title, of any kind whatever, from any King, Prince or foreign State.

Section 10. No State shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money, emit bills of credit, make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, *ex post facto* law, or law impairing the obligation of contracts, or grant of title of nobility.

No State shall, without the consent of the Congress, lay any imposts or duties on imports or except what may be absolutely necessary for executing its inspection laws; and the net produce of all duties and imposts, laid by any States; and all such laws shall be subject to the revision and control of the Congress.

No State shall, without the consent of Congress, lay any duty to tonnage, keep troops or ships of war in time of peace, enter into any agreement or compact with another state, or with a foreign power, or engage in war, unless actually invaded, or in such imminent danger as will not admit of delay.¹

It will be seen that the taxing powers of the Federal Government and the States are concurrent in nature. But, to prevent the possibility of one Government taxing the activities of another out of existence, the Supreme Court laid down, at an early date, that the instrumentalities of one State were constitutionally immune from taxation by another.² The States were specifically prohibited from levying either import or export duties, except with the consent of the Congress and only for executing its inspection laws (Article I. Section 10 above). Thus, the American Constitution made the whole country economically one by preventing the States from levying taxes on foreign and interstate commerce. An important phrase occurring in Section 8 of the American Constitution is "general welfare of the United States". The Congress has power to levy taxes, duties, etc. for anything which it considers to be good for the "general welfare" of the United States. This gives the

¹ The United States of America, *A Government by the People* (The Department of State), pp. 104-105.

² P. Studenski & E. Herman Krooss, *Financial History of the United States* (McGrawhill, 1952), pp. 3-9-40.

Congress a great deal of discretion. For, the phrase "general welfare" can be interpreted in a different manner in different ages. As a matter of fact, even in the early days of the American Republic, there were differences in points of view. Alexander Hamilton thought that "general welfare" meant anything which was not purely local, while Jefferson thought that it added nothing to the powers already enumerated in Section 8.

Another important phrase is "direct tax" occurring in Section 9. A "direct tax" can be levied only by apportionment among the States in accordance with the population. There was much discussion about the meaning of this word "direct tax". Initially, it was held by many that only real property and toll taxes were "direct taxes." Later on, the Supreme Court was inclined to a broader interpretation; and finally in 1913, by an amendment to the Constitution the Sixteenth Amendment, the Federal Government was permitted to levy tax on personal and corporate incomes without apportionment.

It will be seen that the Constitution gave the Federal Government almost unlimited fiscal power. Every form of tax, whether or not in force in the States, was leviable by the Federal Government. In addition, taxes on imports were reserved solely for the Federal Government. Public lands were also solely under the jurisdiction of the Federal Government and this gave them great monetary advantage. At the present time the more important sources of Federal and State Government funds are as follows:—

Federal

Income tax. Levied on the incomes of persons and business organisations. The rates increase with the size of the income.

Inheritance tax. Levied on the heirs and beneficiaries of estates. Large gifts of money and property made by one person to another are similarly taxed.

Excise taxes. Imposed on manufactured products, particularly liquor, cigarettes, playing cards, luggage, and electric light bulbs.

Customs duties. Charged on goods brought into the country from abroad.

Corporation tax. Levied on corporations on a basis of capital stock value.

Amusement and luxury taxes. Added to the cost of entrance tickets to places of amusement and to the price of items such as furs, jewellery and perfume.

Transfer taxes. On the sale of exchange of stocks and bonds.

Special purpose taxes. Revenues which are allocated to a specific purpose, such as the Social Security tax on an employee's pay. This type of levy on the employee is combined with a pay-roll tax imposed on the employer to provide the funds from which payments are made to workers during periods of unemployment and in old age.

State

Property taxes. Levied on land, buildings, and equipment.

Inheritance taxes. Nearly all States impose a levy on the estates of deceased residents.

Income taxes. Considerably lower rates than the Federal prototype.

Business taxes. On the earnings of companies and corporations within the State.

Franchise taxes. On private enterprises whose business requires extensive use of public property and facilities such as the highways.

Gasoline tax. Imposed at point of retail purchase and frequently authorised only to raise funds to defray highway costs.

Sales tax. A general levy resorted to by some States on all retail purchases.

Special assessments. Charges for paving, sewers and like improvements on the land and buildings the value of which is increased by the improvement.

A wide assortment of fees, tolls, and fines

These items include small charges made for recording documents, use charges for canals, bridges and ferries, and fines assessed against persons convicted of minor infractions of the law.³

At present about two-third of the total tax revenue of the country goes to the Federal Government.⁴

A wide element of flexibility in the U.S. Constitution is provided by the interpretative power of the Supreme Court. So far as the tax-levying and borrowing powers of the Federal and State Governments go, however, there is not much scope for Supreme Court interpretation. The Americans, like the British, have been, and are, very good in financial matters. There is very little vagueness in the American Constitution about the fiscal powers of different units. However, should there be any irreconcilable difference about the interpretation of the Constitution, then the arbiter is the Supreme Court.

Canada. The best source material in regard to relations between the Dominion Government and the Provinces is the Rowell-Sirois Report, published in 20 volumes in 1940. A very brief account of this is given in pages 4-8 of my report, "The Role of the Canadian and U.S. Governments in the Promotion and Execution of Economic Development Schemes".⁵

The Dominion and Provincial authorities derive their powers from the British North America Act, 1867. The provinces formed after 1867 or territories joining the Confederation after 1867 are also governed by this Act. So far as we are concerned in this book, the most important Sections of this Act are 91 and 92. Section 91 lays down that anything which pertains to the "peace, order and good government of Canada" falls within the jurisdiction of the Dominion Government. Certain items have been specifically included

³ *A Government by the People* (U.S. Department of State), pp. 93-94.

⁴ Studenski & Herman E. Krooss, *Financial History of the United States*, (McGrawhill, 1952) p. 485.

⁵ Published by the Government of India in 1953.

as falling within this category, like "the raising of money by any mode or system of taxation" and "the borrowing of money on the public credit". It will be seen that "peace, order and good government" is very much akin to the "General Welfare" clause of the U. S. Constitution.

Under Section 92 "direct taxation within the province in order to raise revenues for provincial purposes" as well as "the borrowing of money on the sole credit of the province" are provincial matters. Indirect taxes like customs and excise thus automatically became Dominion subjects. Roughly speaking, in 1867, 83 per cent of the revenues comes from customs and excise duties.⁶ The Provinces were left with the "direct taxes," royalties, odd fees, permits, and sales of small services for raising revenues. To prevent unfairness, the Dominion took over the provincial debts and such costly functions as national security, national development, the fostering of trade and commerce, etc. A system of annual, per capita, and special grants from the Dominion to the provinces was also instituted. We shall deal with these grants in Chapter 2.

By the eve of World War II, provincial functions had expanded very much but the revenues had not risen accordingly. For instance, public health measures, old age pensions, unemployment relief, etc. were either wholly unknown or known to a limited extent in 1867 as compared to 1937. In 1937, therefore, a Commission was appointed to go into the whole matter. This Commission is generally known as the Rowell-Sirois Commission after the names of its two chief members. The Rowell-Sirois Commission recommended:—

(a) The adjustment of certain powers between the Dominion and the Provinces and a consequential adjustments of taxing powers.

(b) The institution of a system of special grants from the Dominion Treasury to equalise the financial and economic position of the Provinces, the Dominion contribution being based solely on the principle of provincial fiscal need. In more detail, the Provinces

⁶ *Rowell-Sirois Report*, Vol. I, pp. 41 and 45.

would relinquish the personal income-tax, taxes on co-operation, and on corporate income, and succession duties and surrender the old form of provincial subsidies. The Dominion will assume all provincial debts hitherto incurred and responsibility for all relief of the employable unemployed. The Dominion will pay 10 per cent of the net revenue derived from mining and oil-producing Companies within the Provinces to these Provinces; and to needy provinces a "National Adjustment Grant" to be determined on the needs of the provinces, and to be reviewed every 5 years by an independent Commission. Emergency grants would be given to Provinces suffering under exceptionally bad economic conditions.⁷

The Rowell-Sirois Report was shelved. But the logic of events, especially after World War II, and its aftermath, have led to the adoption of many of the features recommended by the Rowell-Sirois Commission. This has been done by what are known as the "tax rental agreements". By such agreements, the Provinces relinquished certain "direct taxes" like personal income-tax and Corporation tax to the Dominion in lieu of grants, for an agreed period of three years. This was in 1942. In 1940, unemployment insurance had already been transferred from the Provinces to the Dominion by a constitutional amendment. In 1944, the Dominion Government introduced a nation-wide system of family allowances. Under the new circumstances, following the assumption of such extra responsibilities and the aftermath of World War II, there was a new proposal on the part of the Dominion Government (1946). The Dominion Government agreed to a higher rate of subsidy to the Provinces, at 12 per head, in return of complete control of personal income-tax, corporation taxes and succession duties. By 1952, all the Provinces entered into "tax rental" agreements with Dominion Government, whereby control over direct taxes was given up for an agreed subsidy per head of the population *plus* the statutory subsidy on the date of "renting

⁷ O.K. Ghosh, *The Role of the Canadian and U.S. Governments in the Promotion and Execution of Economic Development Schemes* (Government of India, 1953), p. 7.

out." Only Quebec held out, largely because of differences of religion and language. The population of Quebec is overwhelmingly Roman Catholic, and hence the Quebec Government were chary in giving powers over succession duties to the Dominion Government where the influence of the English-speaking people, with possibly different views on the size of families and succession matters, are likely to be stronger.

Australia. Towards the end of 1946, two officers of the Government of India, Mr. B. K. Nehru and Professor B. P. Adarkar, went to Australia to study the system of federal finance obtaining there. Their report was submitted to the Government of India in February 1947, entitled "Report on the Australian System of Federal Finance and its Applicability to Indian Conditions." This is a convenient source material for our purpose and references will be made to this report in this section, styled as the "Nehru-Adarkar Report."

In the Australian Constitution of 1901, financial relations between the Commonwealth and the States were stated to be in the nature of temporary arrangements, the "permanent" solution being postponed for subsequent legislation.⁸ Under Section 51, the Commonwealth enjoys a plenary power of taxation subject to two conditions. The first is that taxation should be levied "so as not to discriminate between the States or parts of States", and secondly, that there should be reciprocal immunity of Government property from taxation. Under Section 90, the Commonwealth has exclusive power to impose customs and excise duties. The remaining portion of the taxation field is not divided, the States having full powers of taxation in all fields except customs and excise. Commonwealth taxes are, therefore, customs and excise as well as pay roll tax, estate duties and land tax. Income-tax has also now been centralised. The States have had recourse to income-tax (now centralised), probate and succession duties, stamp duties, land tax and taxes on entertainment, motor vehicles, and liquors and licences of different kinds.

⁸ *Nehru-Adarkar Report*, p. 4.

In Australia, as in Canada, the distribution of financial powers has not been adequate for the States. There have been several methods by which the Federal Government has given sums to the States out of its own revenues. The main arrangement which has prevailed from 1942, apart from specific grants, has been that in return for the centralisation of the income-tax, the Federal Government has made large reimbursements out of income-tax proceeds to various States.

U.S.S.R. In the U.S.S.R., the two main features which concern us here are the "unified budget"¹⁰ and "democratic centralism".¹¹ The "unified budget" system means that the budget which is presented to the Supreme Soviet of the U.S.S.R. consists of the following:—

- (i) The All-Union State Budget.
- (ii) The State Budget of Union and Autonomous Republics.
- (iii) The local budgets, *i.e.* the budgets of provinces, regions, districts, towns, etc.

It is laid down in Article 14 of the Constitution of the U.S.S.R. that the "approval of the consolidated state budget of the U.S.S.R. and of the report on its fulfilment; determination of taxes revenues which go to the Union the Republican and the local budgets" pertain to the all-Union sphere. "Democratic centralism" means that each superior organ has the right to annul the orders of lower bodies.¹² This is also laid down in the Constitution of the U.S.S.R., *vide* Articles 60, 97.

The Soviet system is, therefore, a federal system, so far as the distribution of financial powers go, only in name. It is really a unitary system, and the form of planning which exists in the U.S.S.R. perhaps makes the adoption of a unitary system inevitable. In the budgets of the Union

⁹ *Neburu-Adarkar Report*, p. 6.

¹⁰ N.N. Rovinskii, *Finansovaya Sistema U.S.S.R.* (Gosfinizdst-Moscow, 1952), p. 49.

¹¹ S. Ostrovityanov and others, *Politicheskaya Ekonomiya* (Moscow, 1955), p. 556.

¹² V. Karpinsky, *How the Soviet Union is Governed* (Moscow, 1954), pp. 56-57, 62, 63, 66.

Republics, the revenues are generally in excess of the expenditure while in the case of local bodies, the expenditure is in excess of revenues.¹³ In 1952, about 80 per cent. of the unified budget pertained to all-Union activities and only 20 per cent to activities of Union Republics and local authorities. Out of this 20 per cent again, only about 6 per cent related to the Union Republic and 14 per cent to autonomous and local bodies.¹⁴

One need not go into greater detail about the Soviet system. It is clear from the above figures and from the constitutional position cited above that the Centre in the U.S.S.R. is much more important than in other federations. The local and autonomous bodies raise revenues from the profits of local enterprises, rent from local bodies and from other local rates and taxes. For the rest, sums are assigned by the Supreme Soviet. In making budgetary estimates such possible assignments are taken into account.

India. Before 1858, the financial system in India was highly centralised, under which the Governor-General-in-Council retained complete control over provincial resources as well as expenditure. Except for surcharges levied on land revenue in certain provinces to finance local services, the provincial governments had to depend entirely on the Centre and even the most trivial expenditure required the sanction of the Government of India.¹⁵ New ideas came into the Government of India only with Mr. James Wilson. He took charge as India's first Finance Minister in 1859. Mr. Wilson was an economist, who had founded "The Economist." As such he brought in a whiff of fresh air. He was in India for only about ten months. But he laid the foundations of the present system of Indian financial administration. He introduced the income-tax, but due to financial stringency could not start any scheme of devaluation of financial powers to the provinces. It was Lord Mayo, who by a resolution in 1877, first introduced a measure of decentralisation. There was further decentralisation by

¹³ Alexandar Baykov, *The Development of the Soviet System*, (Cambridge, 1950), p. 389.

¹⁴ Royinskii, *Op. Cit.*, p. 50.

¹⁵ *Report of the Simon Commission*, Vol. I, p. 343.

Lord Ripon in 1880 and in the settlement of Lord Curzon in 1904. The basic idea was to make over to the provinces certain heads of revenue and expenditure and to require them to balance the two. When such balancing was not possible, assignments were made by the Centre.

In 1919, following the Montagu-Chelmsford Reforms, the "divided heads" of revenue system, which had prevailed so long, was abolished, and a complete separation made between Central and provincial sources of revenue.¹⁶ Income-tax and general (or commercial) stamps were made entirely Central under the new scheme of things, and excise, judicial stamps, land revenue and irrigation were given to the provinces. It was estimated that this clear-cut division would mean a large deficit for the Government of India, and hence contributions from the provinces to the Government of India were visualised. These contributions were specified by the Meston Committee in 1920. But the estimates of the financial experts proved faulty. The provinces were actually in more need of money than the Centre, and ultimately in 1928-29 the provincial contributions were abolished. The sources of revenue assigned to the provinces were inelastic, the more elastic sources of revenue like income-tax and customs having been allotted to the Centre. Also, while agricultural provinces received a welcome accession of resources in land revenue which was the most important source of revenue at that time, the revenue of industrial provinces did not benefit to that extent as income-tax proceeds went to the Centre. It was found necessary, therefore, right from 1920-21 to use the income-tax as the balancing factor.¹⁷ This balancing was made specific and formal in the recommendations of Sir Otto Niemeyer in 1936, following the Government of India Act, 1935. Niemeyer recommended that 50 per cent of the net proceeds of income-tax should be assigned to the provinces. As regards the distribution of the provincial share, Niemeyer's percentages were based partly on residence and partly on population. Niemeyer also recommended certain *ad hoc* grants to various States, the sharing of a greater portion of the jute export duty between

¹⁶ Report of the Finance Commission, 1952, p. 12.

¹⁷ Report of the Finance Commission, 1952, p. 13.

the jute growing states ($62\frac{1}{2}$ per cent from the earlier $12\frac{1}{2}$ per cent) and the cancellation of the outstanding debts to the Centre of certain provinces. Niemeyer's recommendations were accepted.

The next stage came when the Indian Constitution was being drafted. An Expert Committee was set up by the Constituent Assembly under the chairmanship of Mr. N. R. Sarkar. The Sarkar Committee recommended that the whole of the income-tax, including the corporation tax and income-tax on federal emoluments should be shared between the centre and the units except to the extent of the tax attributable to centrally administered areas. They suggested that the provincial share should be fixed at 60 per cent and allocated among the provinces as follows:—

- 20 per cent on the basis of population;
- 35 per cent on the basis of collection;
- 5 per cent for mitigating hardship.

They suggested the doing away with the sharing of the jute export duty as they thought that export duties should not be shared with provinces. They suggested, however, that there should be some provincial sharing in the Central excise duties. They also recommended that export duties should be wholly Central. And finally, they recommended that a Finance Commission should be set up to deal with the financial relations between the Centre and the States and the distribution of divisible Central taxes between the various States.¹⁸

Partly as a result of the Sarkar Committee's recommendations, the division of resources between the Indian Union and the States is very clear-cut, as given in the Seventh Schedule to the Indian Constitution. According to this schedule, the sources are as follows:—

A. Union Sources

1. Taxes on income other than agricultural income.
2. Customs duties including export duties.
3. Duties of excise on tobacco and other goods manufactured or produced in India except (a) alcoholic liquors for human consumption and

¹⁸ *Report of the Finance Commission, 1952, p. 20-23.*

- (b) opium, Indian hemp, and other narcotic drugs and narcotics.
4. Corporation tax.
 5. Taxes on capital value of assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies.
 6. Estate duty in respect of property other than agricultural land.
 7. Duties in respect of succession to property except agricultural land.
 8. Terminal taxes on goods or passengers carried by railways, sea, or air; taxes on railway fares and freights.
 9. Taxes other than stamp duties on transactions in stock exchanges and futures markets.
 10. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, insurance policies, transfer of shares, debentures, proxies, and receipts.
 11. Taxes on sale or purchase of newspapers and on advertisements published therein.
 12. Fees in respect of any of the matters in the Union list except fees taken in any court.

B. State Sources

1. Land revenue.
2. Taxes on agricultural income.
3. Duties on succession to agricultural land.
4. Estate duty in respect of agricultural land.
5. Taxes on lands and buildings.
6. Taxes on mineral rights subject to limitations imposed by law.
7. Excise duties on alcoholic liquors for human consumption and opium, hemp, and other narcotic drugs.
8. Taxes on the entry of goods into a local area for consumption, use or sale therein.
9. Taxes on consumption of sale of electricity.
10. Taxes on the sale or purchase of goods other than newspapers.

11. Taxes on advertisements other than those published in the newspapers.
12. Taxes on goods and passengers carried by road or inland waterways.
13. Taxes on vehicles for use on roads.
14. Taxes on animals and boats.
15. Tolls.
16. Taxes on professions, trades, callings, and employments.
17. Capitation taxes.
18. Taxes on luxuries, entertainments, betting and gambling.
19. Rates on stamp duty on documents other than those subject to Union stamp duty.
20. Fees in respect of any of the matters in the State list.

Stamp duties other than those collected by means of judicial stamps, but excluding rates on stamp duty, and fees in respect of any of the matters in the concurrent list, are concurrent sources. These are not so important, as the Union and State lists are fairly exhaustive. Pending the appointment of a Finance Commission under Article 280 of the Constitution, there was an *interim* arrangement known as the Deshmukh Award. Under this award only some consequential changes were made in the Niemeyer Award, necessitated by the partition of India.¹⁹

The First Finance Commission philosophised that "the prosperity of the States must rest on the solid foundation of a reasonably strong and financially stable Centre".²⁰ With this philosophy in mind, they did not go so far as the Sarkar Committee and recommended that the percentage of the net proceeds of income-tax to be allocated to the States be raised from 50 per cent to 55 per cent only and not to 60 per cent. As between the various States they proposed that 20 per cent of the income-tax proceeds should be divided on the basis of relative collections of tax and 80 per cent on the basis of relative population according to the census of 1951.²¹

¹⁹ *Report of the Finance Commission, 1952*, pp. 24-25.

²⁰ *Report of the Indian Finance Commission, 1952*, p. 7.

²¹ *Op. Cit.*, p. 76.

Conclusions. It will be seen that so far as the division of financial powers between the Centre and the States go, the Indian system has possibly more practical rationalism and logic behind it than the system of any other federation. In coming to this conclusion the Soviet system is left out, as properly speaking, it is a unified system and not a federal system in the sense the word "federal" is understood in the U.S.A., Canada, Australia and India. The basic logic in dividing the sources of revenue between a central government and different units would be to keep indirect taxes, like customs duties and export duties, with the centre and allocate the others among the states. This is how the U.S. system of distribution of taxation powers began. The Canadian and Australian systems undoubtedly derived their inspiration to a great extent from the American system. But a very large source of modern revenue is the income-tax, a direct tax. And, either by an amendment of the Constitution as in the U.S.A. (the Sixteenth Amendment) or by agreements as in Canada and Australia, income-tax revenues have had to be taken over either wholly, or very substantially, by the central government. India has profited by the experience of these federations. Meston and his financial experts in 1920 could not apparently visualise that the income-tax would become very important in India and hence they were against sharing it with the provinces.²² Provision for sharing it was, nevertheless, made. And, to-day, the share of income-tax in the revenues of various States in India is on the average between 12 to 15 per cent.²³ In India the financial powers have also been clearly demarcated, as laid down in the three lists attached to the Seventh Schedule to the Constitution. Finally, the provision of the Finance Commission every five years to study the relationship between the financial needs and resources of the Centre and the States is a guarantee that the needs of democracy, in the sense of the rights of the States, would receive regular and periodic high-level independent attention.

The first Finance Commission (1952) recommended that a body should be set up to make a continuous study of the

²² *Report of the Finance Commission, 1952*, p. 12.

²³ *Reserve Bank of India Bulletin*, May 1956, pp. 492-495, 504-507.

finances of the State Governments and of interrelated matters.²⁴ Such a recommendation had been made earlier by academic people also. For instance, P. J. Thomas, as far back as 1939, stressed the necessity for "a clearing-house of information in the Central Government".²⁵ The Indian Taxation Enquiry Commission, 1953-54, have recommended the setting up of an Inter-State Taxation Council under Articles 263 of the Indian Constitution, to study common problems of taxation and to secure, by research and mutual consultation, such measures of agreement in taxation matters as may be possible.²⁶ It might be more economical from the point of view of time and energy and personnel, as well as money, to have one such body rather than two. It might be said that the Planning Commission and the Economic Division of the Ministry of Finance perhaps fulfil the required functions. One would suppose, however, that these bodies would be busy more with a wider kind of operational research than with the sort of research which the first Finance Commission and the Taxation Enquiry Commission have had in mind. To some extent, duplication in thinking cannot be avoided and perhaps should not be avoided. A clearing-house for information and research as recommended by the first Finance Commission and the Taxation Enquiry Commission, 1953-54, with suitable liaison with the Planning Commission and the Ministry of Finance, might perform useful functions, provided the sphere of studies of the various organisations involved are laid down as clearly as possible. In the U.S.A. the Council of State Governments largely fulfils such a role, though in a wider context.²⁷

²⁴ *Report of the Finance Commission*, 1952, p. 110.

²⁵ P. J. Thomas, *The Growth of Federal Finance in India* (Oxford University Press, 1939), p. 459.

²⁶ Vol. I, pp. 167-169.

Vol. II, pp. 75.

²⁷ O.K. Ghosh, *The Role of the Canadian and U.S. Government in the Promotion and Execution of Economic Development Schemes* (Government of India, 1953), p. 52, *et seq.*

CHAPTER 2

LOANS AND GRANTS TO STATES FROM THE CENTRE

The Problem. The aim of a Welfare State is, among other things, to lessen inequalities in opportunities between man and man. In a federation some states are richer than others. This may be due to the reason that they have better natural resources. Or, they may have been developed for a longer time. Or, it may be a combination of both the reasons. As a consequence, the inhabitants of certain states might find themselves with lesser opportunities and facilities of different kinds because its government is poor compared with those of other states. The problem is much more acute in underdeveloped countries, like India, than in highly developed countries like the U.S.A. and Canada. Even in the U.S.A. there might sometimes be problem. Witness the Tennessee river valley of three decades ago. Professor V. G. Ramakrishna Aiyar, in an article in the "*Capital*", of Calcutta, speaks of disparities between different states being removed by a system of grant-in-aid from the Centre.¹ Therefore, for this chapter "democracy" may be taken to mean the extent to which the loans and grants system of various federations serve to remove disparities in the resources of the different units in a federation, as compared to their needs.

U.S.A. In the U.S.A., provision for the federal grant of land for schools was made as far back as 1785. This is known as the "land grant method" for educational purposes. In 1802, when Ohio was admitted to the Union, one section in each township was granted to its inhabitants for the use of its schools. In 1848, the grant was increased to two sections per township and 14 States entered the Union with this generous endowment. It has been estimated that at least 130 million acres of federal land have been granted to States for the purpose of aiding schools. Grants have also been

¹ Supplement to *Capital* of 20th December 1956, p. 97.

made by the Federal Government to States for higher education; and 64 million acres have been distributed by the Federal Government to States for flood control and the draining of marshy areas.²

The above measures, however, are applicable only where a new country is being settled.

The modern system of grants-in-aid in the U.S.A. owes its origin to Representative Morrill of Vermont. The first Morrill Act was passed by the U.S. Congress in 1862. Under the Morrill Act system, land grants were made by the Federal government to various States for specified educational purposes. Each State sold as much land as was not required and had to report to the Congress annually about the sums received and the disposition of the funds. The States were required to invest such funds in safe securities and spend only the interest from these investments, retaining the principal as endowment funds. No portion of this interest could be used for construction purposes, which were direct obligations of the States. In other words, State "matching" was thus secured by the restriction denying the use of federal funds for construction purposes. The grants were, therefore, conditional. In 1890, a second Morrill Act provided for each State an annual grant, gradually rising to \$ 25,000, to be spent for constructional purposes in land grant of colleges. There was a clause in the second Act empowering federal officials to withhold grants from any institution not fulfilling its obligations satisfactorily. Thus, these grants were cash grants, conditional upon compliance with certain federal standards. It has been held that the Morrill Acts not only laid the foundation of the present U.S. grants-in-aid system, but that they constituted the major factor in assuring opportunities for higher education in the newer sections of the population of the United States.³

² *Federal Grants-in-Aid* (The Council of State Governments, Washington 1949), pp. 2-4 ;

O. K. Ghosh, *The Role of the Canadian and U. S. Governments in the Promotion and Execution of Economic Development Schemes* (Government of India, 1953), p. 46.

³ O. K. Ghosh, *Op. Cit.*, pp. 46-47.

Soon the Morrill model was extended to the agricultural experimental stations, agricultural extension work, forestry, highways, vocational education and rehabilitation, public health and emergency relief. The Social Security Act, 1935, authorises, *inter alia*, grants for old age assistance, aid to the blind, aid to dependent children, unemployment compensation, administration of employment offices and crippled children services. Since 1916, there has been extensive Federal aid for highways; and, especially since World War II, extensive aid for the State construction of aerodromes. Public Law 377 of 1946 authorised a seven-year programme for this purpose, up to a total of \$ 500 million. Grants for this purpose are apportioned among the States according to relative population and area (except for 25 per cent placed in a discretionary fund) and local matching is required. The grants for airports are generally on a 50: 50 basis, but the federal share is considerably less than half in regard to land acquisition and the cost of large airports.⁴

In the U.S.A. the government have entered very little indeed into the economic development field. Apart from the TVA, there is really no large governmental economic enterprise. Even the railways, telephone services, etc. are private. On the other hand, basic necessities like roads, aerodromes, agricultural extension services, public health measures, schools and colleges have been well looked after by the Federal and State Governments and the Federal Government has aided the State governments in these matters. As regards the method of apportionment in general between different States, the following factors are taken into account:—

- (a) population,
- (b) area,
- (c) financial need,
- (d) amount spent by the States,
- (e) other needed factors.⁵

The Council of State Governments has described the methods of apportionment in detail in their book "Federal Grants-in-Aid" which, though apparently freely available to those interested, does not seem to be a saleable publication. In

⁴ O. K. Ghosh, *Op. Cit.*, pp. 47-50.

⁵ O. K. Ghosh, *Op. Cit.*, p. 49.

all grant programmes State matching is insisted upon and there are efforts to analyse per capita grant benefits in as scientific a manner as possible. The conclusions which the Council of State Governments reached regarding such scientific efforts is as follows:—

“Congress consciously developed grants for highways and airports so that the sparsely settled states of the west would not be burdened unduly. This one factor heavily skews the present incidence of federal aid in favour of the so-called public-land states. The position of the rest of the states is less easy to determine”.⁶

It will be thus seen that there has been an effort to help the less developed states regarding roads and aerodromes, but apart from this no general conclusion can be drawn as to which State has been helped more, relatively, than others. That is to say, it has not been possible to lay down mathematical formulae whereby central assistance can be doled out more or less in a mechanical manner to different states. A large margin for judgment (or possibly for pressure) exists.

Canada. In Canada the question of grants has always been important. The British North America Act, 1867, laid down what subsidies should be paid by the Dominion Government to the Provinces (Sections 102-126). These subsidies fall under the following heads:—

- (a) debt allowances,
- (b) annual grants to support provincial governments and legislatures,
- (c) per capita grants,
- (d) special grants.

(b) and (c) above are sufficiently descriptive and (d) perhaps requires no special explanation. As regards (a) this related to payments to cover debts incurred by the Provinces, mainly on railway property, which passed over to Dominion ownership in 1867.⁷ The debt allowance was calculated

⁶ *Federal Grants-in-Aid* (The Council of State Governments Washington 1949), p. 88.

⁷ O. K. Ghosh, *The Role of the Canadian and U. S. Government in the Promotion and Execution of Economic Development Schemes* (Government of India, 1953), p. 5.

at a lump sum per head on the average. The annual grants to support provincial governments and legislatures were on an *ad hoc* basis and different sums were allotted to different Provinces. The major contribution of the Dominion Government to Provincial revenues, however, in the days of their early growth was by means of the per capita grant. Special grants have been given for special purposes and the pressure on account of political considerations, especially from the Maritime provinces, has been reputed to be great.⁸

Since 1867, there have been more than 20 special revisions and three general revisions on all these matters. The number of these revisions have, like the original arrangements, been declared as "final" and "unalterable".⁹

In Canada also it has not been possible to work out any mechanical formulae for the apportionment of grants between different states. The conditional grant system was introduced in 1912 and matching in different forms was insisted upon. Here also, no mechanical formulae could be arrived at, although, as in the U.S.A., statistics and figures are analysed in detail before grants are agreed upon.¹⁰

It is interesting to note, in this connection, that the Rowell-Sirois Commission recommended that functions should be either Dominion or Provincial, and that there should be no joint operations as such.¹¹

Australia. In Australia, grants are both unconditional and conditional. Unconditional grants have been far more important in Australia than conditional grants. Thus, Mr. B. K. Nehru and Professor B. P. Adarkar found in 1945-46 that about 1/4th of all federal assistance was conditional and 3/4th unconditional.¹²

Australia has three very special institutions which have attracted attention. They are:—

(i) The Commonwealth Grants Commission.

⁸ O. K. Ghosh, *Op. Cit.*, p. 6.

⁹ O. K. Ghosh, *Op. Cit.*, p. 6.

¹⁰ O. K. Ghosh, *Op. Cit.*, p. 6.

¹¹ O. K. Ghosh, *Op. Cit.*, p. 7.

¹² *Nehru-Adarkar Report*, p. 7.

(ii) The Australian Loan Council.

(iii) The National Works Council.

The Commonwealth Grants Commission was established by statute in 1933. The aim was to ensure the examination of the claims of needy States for "special grants" by an impartial tribunal. The Commission consists of three members of whom one is the chairman. These appointments are not whole-time and are for terms not exceeding three years. All evidences given by witnesses before the Commission are on oath or affirmation and if a person refuses to give the required information, he can be fined.¹³ The Commission have tried to sift the real facts behind the "window-dressing" of state claims. In their assessments they have laid stress on principles like "severity of taxation" and "budgetary standards". By statistical analysis they have arrived at budgetary norms, expressed per head of the population of each state. The comparisons have been made mainly on this basis. Although the Commission have spent years in trying to work out formulae, it has not been possible to rely wholly on mathematics. A large element of judgment (and of pressure) comes in. But there is no doubt that the Commission idea is a good one and that it has laid down some basic principles of a measurable nature.¹⁴

The Australian Loan Council was created in 1923 as a central authority to determine all borrowing, conversions, renewals policy, etc. From 1923 to 1927 it functioned as a purely advisory body, but from 1928 it became the formal machinery of borrowing, in pursuance of Sections 105 and 105A of the Australian Constitution. The Loan Council is concerned primarily with the question of allocation of available funds among applicant governments, but it has not interfered with the loan policies of individual governments by questioning the relative urgency of the required loans.¹⁵ This relative urgency of the required loans was determined by the National Works Council, which came into being as such in 1943. The Co-ordinator General of Works, appointed by the Loan Council, also functions as Co-ordinator

¹³ *Nehru-Adarkar Report*, p. 12.

¹⁴ *Nehru-Adarkar Report*, pp. 12-28.

¹⁵ *Nehru-Adarkar Report*, p. 10.

General of the National Works Council. In each State there is a Works Co-ordinator, for liaison with the National Works Council. The National Works Council, the Loan Council and the Commonwealth Grant Commission all work more or less in close consultation, especially the former two organisations.

U.S.S.R.. In the last chapter it was pointed out that in the U.S.S.R the budget is a "unified" one. Sums are spent by different governments according to a predetermined long period plan. About 80 per cent of the sums are spent by the centre. As such, the question of loans or grants from the centre to the states is not a very burning one. Nevertheless, there must be principles according to which grants are apportioned between different units. A perusal of the literature available does not indicate clearly what these principles are. But, apparently, there is a desire to see that per capita living standards, educational and health facilities, etc. became uniform throughout the U.S.S.R. Also, there has apparently been a great desire, especially in Stalin's time, to develop different economic regions each in a more or less independent way. Each region was thus a "complex", which had heavy industry, light industry, mechanised agriculture, etc. So far as we are concerned, due to lack of really significant information, we cannot draw upon the Soviet experience in the matter of allotment of funds from the centre to various states.

India. There is an important difference between India and other federations like the U.S.A., Australia, Canada and U.S.S.R. India is the only country where the centre makes not only grants, but also loans to various states. For instance, long period loans (40 years, etc.) have been made by the centre to the Governments of Bihar, West Bengal, Orissa, etc. for projects like the Damodar Valley, Kosi, Hirakud, etc. The first Finance Commission did not study the question of loans to states. It confined itself to grants. It laid down the following criteria for the consideration of apportionment of grants:—

- (a) budgetary needs,
- (b) tax effort,
- (c) economy in expenditure,

- (d) standard of social services,
- (e) special obligations,
- (f) broad purposes of national importance.¹⁶

It also stressed the necessity of matching in the case of conditional grants.¹⁷ It appears that the first Finance Commission were influenced very much by the work done by the Commonwealth Grants Commission in Australia. The Morrill system cannot obviously be applied to India in an extensive manner. And the Canadian system appears to be very pragmatic indeed, if not chaotic. Australia seems to be the only federation with lessons for us. (We know very little of the Soviet Union, as pointed out above).

Over 17 per cent of the revenues of various States in India are contributed by the Centre in the form of grants of one kind or another.¹⁸ The question arises, however, has there been adequate redistributive effect as regards "backward States" through our system of grants-in-aid? We have seen in Chapter I that the income-tax is distributed substantially (80 per cent) on a population basis, and only slightly (20 per cent) on a collection basis. At the State level undoubtedly there is some redistribution within the State, especially in West Bengal, Madras and Bombay. For instance, the first Finance Commission have produced figures of revenue and expenditure under certain heads in Bombay, Madras and Calcutta and compared them with the relevant figures for the whole State concerned. These figures indicate that much more is collected in these cities than spent there.¹⁹ The recent conclusion of an economist is that the character of Indian public expenditure tends to bring about a "moderate reduction" of inequalities both in economic and social life.²⁰ He has calculated that the combined expenditure of the Central Government, State Governments and local authorities in 1953-54 was Rs. 1,170 crores which formed only 11 per cent of the national income.

¹⁶ *Report of the Finance Commission*, 1952, pp. 96-98.

¹⁷ *Op. Cit.*, p. 95.

¹⁸ *Report of the first Finance Commission*, p. 49.

¹⁹ *Report of the first Finance Commission*, pp. 194-195.

²⁰ Professor V. G. Ramakrishna Aiyar, Supplement to *Capita I* of 20th December 1956, p. 99.

Out of this 11 per cent the central share may be computed at about 4 per cent. Hence, roughly about 1 per cent of the national income is made available from the Centre to the States in the form of loans and grants. The redistributive effect cannot, therefore, be very great.

Loans from the Centre to the States. From the layman's point of view it is somewhat difficult to understand why there should be long-term loans from a federation to various units. This feature, which exists in India, is not to be found anywhere else. Presumably, the idea is that if loans are given and if States have to pay interest thereon, they would be more careful in using the money. As the loans are generally of a very long-term character, *viz.* 40 years, etc. it is to be doubted whether they can be really classified as "loans" in the proper sense of the term. Also, many States get further loans for the repayment of interest, as they are too hard-up to constitute sinking funds. To a layman the whole system of loans from the Centre to the States might perhaps seem to be somewhat fictitious.

Execution of certain Projects in States by the Centre. A suggestion has been made by Mr. Ashok Kumar Chanda, Comptroller and Auditor General of India, that in lieu of the Centre rendering financial aid to the States for a proportion of the expenditure on *all* the approved schemes, they should accept full financial responsibility for a specified number of such schemes, up to an equivalent amount. Programme Advisers (in the Planning Commission) should also, he suggests, be required to report that the remaining schemes have been undertaken by the States out of their own resources.²¹ This proposal will not, of course, distribute the national income in a better way than at present, so as to have a greater redistributive effect. But it should ensure that there is a better return per rupee of the central money spent and this will, to some extent, have a better redistributive effect. In this connection, the recommendation of the Canadian Rowell-Sirois Commission against joint ventures between the Centre and the States is pertinent. There is no reason to think that the States will not co-operate with the Centre unless the ventures are joint ones. In countries

²¹ *Central Government Audit Report* (Civil), 1955, Part I, p. 38.

like the U.S.A., Canada, etc. conditions attached to grants are strictly observed. Where conditions are not fulfilled the grants lapse. In India it may not be possible to be so severe, as provincial, linguistic, etc. feelings come to play, a feature absent in the U.S.A., Canada, etc. Hence "matching" grants, to the extent that grants are "conditional" (*i.e.* excluding unconditional grants like sharing of income-tax proceeds) might perhaps be substituted by the system suggested by Mr. Chanda. On the other hand, there appears to be very weighty feeling that in India States would put on their best endeavour to raise resources if the system of sharing is followed.

Conclusion. A survey of the system as obtaining in the U.S.A., Canada and Australia shows that in these federations there are conditional and unconditional grants from the centre to the States, but no system of *loans* from the Centre to the States exists. The advantages of a system of long-term loans from the Centre to the States, and further loans for the payment of interest by the States to the centre are of a doubtful nature. It is also a matter for questioning whether joint operations do not take up more time of officials in discussions, paper work, etc. If they do, then quicker methods of sole execution by a single agency rather than by committees would seem to be preferable. This, in essence, appears to be the suggestion of Mr. Ashok Chanda. In Australia, the Commonwealth Grants Commission scrutinises very closely how the States are utilising the grants. A similar stringent assessment is made throughout the year in the U.S.A. The U.S. Federal Government have their agents in the States to make such assessments. In India, the question of making such assessments has only been recently mooted by the Planning Commission in the Project Economy and Efficiency Committees.

So far as the machinery of grants (and loans) from the Centre to the States go, do we have adequate investigating and assessing institutions for this purpose? The work of the Commonwealth Grants Commission and the National Works Council of Australia is being done by the Planning Commission and the Ministry of Finance of the Government of India. A grants Commission for India, therefore, seems to be uncalled for. If, however, the Centre executes projects,

all over India on behalf of States, then a separate central institution might be advisable, even if not absolutely necessary. Such a recommendation was also made by myself some time ago.²² This institution would have to have close links with the Planning Commission and the Central Finance Ministry (if it does not form part of it) as well as with any research body for taxation purposes which might be set up in pursuance of the recommendations of the first Finance Commission and the Indian Taxation Enquiry Commission (mentioned in Chapter 1).

So far as the question of a wider redistribution of resources from the Centre to the States is concerned, this will depend mainly on the speedy growth of the national income. If only about 1 per cent of the national income continue to be distributed by way of loans and grants from the Centre to the States, the redistributive effect cannot be very much. The main question, therefore, is more one of increase of production than of "doling" out more sums from the Centre to the States.

As regards the proper distribution of the Central Government sums which can be spread out from time to time, the first Finance Commission have laid down certain criteria. The brief study in this chapter of the American, Canadian and Australian systems show that it has not been possible anywhere to work out mathematical formulae. Nevertheless mathematics has to come into the picture. And it has come into the picture. For instance, the first Finance Commission saw what were the trends in different States as regards per capita taxation, per capita expenditure on social service, etc. in assessing their real requirements. It is doubtful if it will be possible to be more mathematical than this. The first Finance Commission also laid down broad principles and recommended specific figures for unconditional grants like income-tax redistribution, etc. Gaps are further filled in by discussions between the Planning Commission, the Central Government and the State Governments. There seems to be, thus, adequate machinery. Whether the public

²² O. K. Ghosh, *The Role of the Canadian and U. S. Government in the Promotion and Execution of Economic Development Schemes* (Government of India, 1953), pp. 51-52.

knows fully what are the reasons behind different grants or loans is another matter. Many witnesses who came before the States Reorganisation Commission did not seem to be quite satisfied in the matter. The States Reorganisation Commission have suggested a separate body to enquire into regional grievances.²³ This, however, is another, although related, matter. Perhaps the Zonal Councils which are now being set up will iron out differences, at least to some extent, in such matters.

²³ *Report of the States Reorganisation Commission*, 1955, (para 841).

SECTION II

THE BUDGET

CHAPTER 3

BUDGETARY CLASSIFICATION

It might be thought that budgetary classification is too dull and tedious a matter to have any bearing on such an exciting subject as democracy. Unfortunately, this is hardly true. Much of the work of democracy, like other work, has to be what some people may call specialised and lacking in wide interest. All work becomes interesting if it has contacts with life. If the control of the budget, which is the very basis of democracy, seems a tedious affair, then perhaps the fault would lie in the presentation of the budget; that is, in budgetary classification. It would be interesting to know what people interested in such matters, but outside government circles, feel. One such person, Professor V. G. Ramakrishna Aiyar, says in this regard:—

“The way the expenditure figures are presented in the Indian budgets does not make the task of analysis easier. For, the general Budget expenditure is classed under more than 90 heads, based on the demands for grants, to which, however, they do not entirely correspond. A further difficulty is that items which appear on both sides of the Budget are shown gross on each side (for instance, the opium monopoly or the somewhat mysterious head “forest”) these must be netted as seems most appropriate in each case before a true account of expenditure can be obtained. The estimates as presented in the Budget are accompanied by short explanatory notes, but these provide an inadequate guide to the content of the various demands or even to the explanation of discrepancies between the Budget and revised estimates. The administrative expenses of a ministry and the cost of the services which it administers are shown separately, but there is no indication of the allocation of costs between the two”.¹

¹ Supplement to *Capital*, December 20, 1936, p. 97.

This comes from a person who is an economist and is interested in State finances. How difficult then must the budget seem to laymen! And unwilling to show their ignorance, and afraid of the jargon of officials, laymen will naturally not touch the budget even with the proverbial barge-pole.

To make matters concrete, I propose to give below the "heads" constituting the budget of a State. I will then take one of these heads and reproduce the sub-divisions within it. Thereafter, I will compare these heads and sub-heads with those devised by Professor Mahalanobis, the famous Indian statistician, and which have been followed in drawing up the Central and State Plans. The heads given below have been taken from a State at random. The position is more or less the same in all States and in the Centre.

DEMANDS FOR GRANTS IN A CERTAIN STATE

Demand No. Service to which the demand relates

- | 1. | 2. |
|-----|--|
| 1. | Taxes on income other than Corporation Tax. |
| 2. | Land Revenue. |
| 3. | State Excise. |
| 4. | Stamps. |
| 5. | Forest. |
| 6. | Registration. |
| 7. | Charges on Account of Motor Vehicles Act. |
| 8. | Other Taxes and Duties. |
| 9. | Irrigation. |
| 10. | Interest on debts and other obligations— <i>Charged</i> . |
| 11. | Appropriation for reduction and avoidance of debt— <i>Charged</i> . |
| 12. | General Administration |
| 13. | General Administration (Welfare, Scheduled Castes, Scheduled Tribes and Backward Classes). |
| 14. | Administration of Justice. |
| 15. | Jails and Convict Settlements. |
| 16. | Police. |
| 17. | Scientific Departments. |

18. Education.
19. Medical.
20. Public Health.
21. Agriculture.
22. Rural Development.
23. Veterinary.
24. Co-operation.
25. Industries and Supplies.
26. Aviation.
27. Miscellaneous Departments (Excluding Crop Statistics).
28. Miscellaneous Departments (Collection of Crop Statistics).
29. Civil Works.
30. Public Works—Establishment—Tools and Plant.
31. Electricity Schemes.
32. Famine.
33. Pensions.
34. Stationery and Printing.
35. Miscellaneous.
36. Public Relations Department.
37. Expenditure on Displaced Persons.
38. Extraordinary charges.
39. Community Development Project.
40. Civil Defence.
41. Payment of compensation consequent upon the abolition of Zamindari.
42. Capital outlay on Industrial Development.
43. Capital outlay on Multi-purpose River Schemes.
44. Road Transport.
45. Capital outlay on State schemes of Government Trading.
46. Loans and Advances bearing interest.
47. N—Public Debt.

TOTAL EXPENDITURE

Now let us take Demand No. 5 "Forest" for a further breakdown (the "forest" which appears so mysterious to Professor V. G. Ramakrishna Aiyar).

Sub-heads under which the grant will be accounted for

A—i I. Timber and other produce removed from the forests by Government agency.

Timber

Firewood and Charcoal

Bamboos

Grass and other Minor Produce

TOTAL—Timber, etc.

A—2—II. Timber and other produce removed from the forest by consumers and purchasers.

III. Communications and buildings.

Roads and bridges ... Major works

... Minor works

... Repairs

Buildings ... Major works

... Minor Works

Repairs

Other works ... Original

” ” Repairs

TOTAL—Communications and Buildings.

IV.—Live-stock, stores tools and plant.

Purchase of stores, tools and plant.

Tool-Live-stock, stores, tools and plant.

V.—Organisation, improvement and extension of forests.

Original—

(i) Government forests.

(ii) Private forests.

Demarcation—

Maintenance of boundaries—

(i) Government forests.

(ii) Private forests.

Sub-heads under which grant will be accounted for

Survey

Compensation for land and right-holders.

Working plans.

Regeneration—

(i) Establishment natural forest.

(ii) Sowing and planting

Afforestation.

Protection from fire.

Other works (Silviculture)

TOTAL—Organisation, improvement and extension of forests.

A—7. VI.—Miscellaneous

Drift and waifwood and confiscated forest produce.

Rent of forests and payment to shareholders in forests managed by Government.

Payment of allowances and profits to landlord.

Payment of cess under the Cess Act.

Law charges.

Cost of living allowance.

Clothing.

Other charges.

Revenue foregone by free grants

TOTAL—Miscellaneous.

VII.—Suspense

A—8. Work advance.

A—9. Deduct-Recoveries of work advance.

TOTAL—Suspense.

A—10 VIII.—Expenditure of account on A.B.C. forests.

Net surplus payable to the owner.

Other payments.

TOTAL—Expenditure on account of A.B.C. forests.

Deduct—Receipts and recoveries on Capital Account.

TOTAL—Conservancy and works.

B—Establishment

- B*—1—Pay of officers ... voted.
B—2—Subordinate forest and depot establishment.
B—3—Other establishment.
B—4—Allowances ... Voted.
B—5—Contingencies—Non-contract Voted.
B—6—Amount recoverable from Khasmahal Department.

TOTAL—Establishment—Vote of
 High Commissioner.

- D*—1—Leave salaries and deputation pay.
D—2—Contribution to Empire Forest Association.
D—3—Other charges—Cost of publications.

Miscellaneous.

TOTAL—High Commissioner Voted.

TOTAL—Charges in England. Voted.

First Five-Year Plan.

Second Five-Year Plan.

TOTAL—Five-Year Plan.

TOTAL—10 Forest.

Except for some items like the allowances of Governors, High Court judges, etc. the legislatures vote all funds. The units by which funds are voted are known as “units of appropriation”. Thus, under the head “Forest” above, the units of appropriation are indicated as *A*—1, *A*—2, *A*—7, etc. Within each of these units “reappropriation” by the executive is possible. That is to say, within each of these units the executive has full authority to spend money up to the amount sanctioned by the legislature. If money is required for an item of expenditure within this unit, but it is found that all the sums estimated have been spent, then there can be a transfer without any difficulty from another item within this unit where there are savings. This is what is known technically as “reappropriation”. A transfer from one unit to another, however, is procedurally a little more difficult, and if this is done irregularly, the sanction of the legislature has to be taken afterwards.

Professor P. C. Mahalanobis has prescribed certain heads for the drawing up of the Second Five Year Plan. These heads are being followed in the Central and State Plans. They are given below:—

Heads and Sub-heads of Development

- o. Agricultural and Community Development.
- oo. Agricultural Production.
- o1. Land Development.
- o2. Warehousing and Marketing.
- o3. Animal Husbandry.
- o4. Dairying and Milk Supply.
- o5. Forests.
- o6. Fisheries.
- o7. Community Projects, N.E.S. & Rural Development.
- o8. Co-operation.
- o9. Miscellaneous.
- 1. **Irrigation and Power**
- 10. Multipurpose Projects.
- 11. Major and Medium Irrigation Projects.
- 12. Minor Irrigation Projects.
- 13. Power Projects—Hydro.
- 14. Power Projects—Thermal.
- 15. Power Projects—Distribution.
- 16. Flood Control.
- 19. Miscellaneous.

2. Industry and Mining

- 20. Factory Production—Producer Goods.
- 21. Factory Production—Consumer Goods.
- 24. Industrial Estates and Townships.
- 25. Village and Small Industries.
- 27. Geological Surveys and Prospecting.
- 28. Mineral Development.
- 29. Miscellaneous.

3. Transport and Communications

- 30. Railways.
- 31. Roads.
- 32. Road Transport; tourism.
- 33. Inland Water Transport.
- 34. Shipping.
- 35. Ports and Harbours.
- 36. Civil Aviation.
- 37. Posts and Telegraphs.

38. Broadcasting.

39. Meteorology.

4. Trade and Commerce

40. Warehouses, Markets and Shops.

41. State Trading—Internal.

42. Imports and Exports.

5. Education

50. Pre-primary.

51. Primary.

52. Secondary.

53. Technical and Vocational (non-University).

54. University—General Arts and Sciences.

55. Higher Professional and Technological Institutions.

56. Social Education.

57. Physical Education.

59. Miscellaneous.

6. Health

60. Hospitals, Dispensaries, Health Units.

61. Water Supply.

62. Drainage and Sanitation.

63. Control of Diseases.

64. Maternity and Child Welfare.

65. Family Planning.

66. Laboratory Services.

67. Medical Education and Training.

68. Systems other than Modern Medicine.

69. Miscellaneous.

7. Housing

70. Industrial Housing.

71. Slum Clearance.

72. Rural Housing.

73. Urban Land Development.

74. Special Housing Schemes.

79. Miscellaneous.

8. Other Social Services.

80. Labour Welfare.

81. Welfare of Scheduled Tribes.

82. Welfare of Scheduled Castes and Backward Classes.

- 83. Social Welfare Extension Projects.
 - 84. Women's and Children's Welfare.
 - 85. Youth Welfare.
 - 86. Welfare of the physically handicapped.
 - 87. Other Welfare Programmes.
 - 88. Rehabilitation of Displaced Persons.
 - 89. Miscellaneous.
9. **Scientific and Industrial Research; Languages, Literature, Arts & Culture, All Other Activities**
- 90. Scientific and Industrial Research.
 - 91. Atomic Energy—Research and Development.
 - 92. Development of National and Regional Languages.
 - 93. Encouragement of Literature.
 - 94. Libraries and Reading Rooms.
 - 95. Encouragement of Arts and Culture.
 - 96. Recreational Activities.
 - 98. Publicity and propaganda.
 - 99. Miscellaneous.

One will at once see how easy it is for the layman to control expenditure if it is presented in accordance with the Mahalanobis categories rather than in the manner that is being followed at present. In Professor Mahalanobis' categorisation the head "Forests" comes under "Agriculture and Community Development". It has an index number "05". Professor Mahalanobis has broken down each of these sub-heads of developments into "detailed heads." These detailed heads relate to administrative staff, training of personnel, research, surveys and statistics, matters specific to the sub-head in question, and "miscellaneous". That is to say, the detailed heads "administrative staff", "training of personnel", "research," "surveys and statistics", and "miscellaneous" are common to all the sub-heads. Other detailed heads are peculiar to the Sub-head concerned. To make the matter clear, I give below Professor Mahalanobis' breakdown of the heads "05—Forests" and "06 Fisheries".

05 Forests

- o administrative staff.
- i training of personnel.

- 2 research, surveys and statistics.
- 3 afforestation and conservation.
- 4 forest industries.
- 5 forest products.
- 6 forest development including roads and buildings.
- 7 wild life preservation.
- 9 miscellaneous

o6. Fisheries

- o administrative staff.
- 1 training of personnel.
- 2 research, survey and statistics.
- 3 tank and beel fisheries.
- 4. river fisheries.
- 5 marine fisheries.
- 6 deep sea fisheries.
- 7 preservation and marketing of fish.
- 9 miscellaneous.

It will be seen that not only has Professor Mahalanobis categorised all the heads and sub-heads of development, more intelligibly than in the ordinary budget, but also that the detailed heads under each sub-head tell a greater story to the layman than the units of appropriation in our budgets. Also, if the units of appropriation are according to the detailed heads worked out by Professor Mahalanobis, not only would democratic control be facilitated. Reappropriation by the executive within each separate functional category of activities would also be rendered much easier. Some might be frightened away by the odd series of numbers like "ooo", "oor", etc. But this is only a statistical method which helps classification.

One does not have to advocate the proposition that Professor Mahalanobis' categories are the best. What is important is not this specific categorisation so much as the method adopted by Professor Mahalanobis. Although, so far as categorisation goes, they seem to be exhaustive and comprehensive. However, there might be scope for amplification in these categories later on.

It may also be mentioned that our "demands for grants" heads do not always correspond with the "account heads", that is to say, the heads under which expenditure is exhibited

in the accounts. This makes matters still more complicated.

Perhaps it may be apposite to consider here some possible objections to the introduction of categories like those advocated by Professor Mahalanobis. It may be said:—

- (a) Has there been any clamour for change?
- (b) If the changes are carried out, will the benefits be in consonance with the great degree of topsyturvyness that might prevail for some time?
- (c) What is the practice in other countries, to which we have been referring so much in the previous chapters?

There does not appear to have been any particular clamour for change, nor does there appear to be such clamour now. So far as officials are concerned, there is no reason why they should want any change. A bureaucracy, by its nature, is conservative. Changes mean the upsetting of routine and routine is the very essence of the day-to-day work of most bureaucrats. There has been no suggestion for change from public men and economists, because I fear, they have been frightened away by the complexity of our “demands for grants”, “units of appropriation” and “heads of account”. So long as the “children of the revolution” are with us, legislative control need not be so rigorous as in the U.K. or in the U.S.A. But later on, when the time comes for such control, it will be found that the control would be very much on paper if Government business is not understood fully by laymen. Prof. Wheare calls the modern British system of government “parliamentary bureaucracy”. It is the same in India also, but as days go, the “parliamentary” portion of the phrase “parliamentary bureaucracy” might become mainly nominal in budgetary matters.

If Professor Mahalanobis’ categories or similar categories are followed, then both popular control of the budget and popular contribution in its formulation would be rendered easier. It will also be easier for legislators later on to see how far the different “functions” of the State have actually been carried out. At present, after all expenditure has been incurred they are presented to the legislatures in the form of “appropriation accounts”, where the expenditure actually

incurred is shown against various units of appropriation for which funds have been voted. If this is according to categories like those of Professor Mahalanobis it will be easier to understand what exactly has been done. If greater democracy is achieved by changes in budgetary classification, then obviously any inconvenience to civil servants cannot be considered to be more important.

In other countries like the U.K., U.S.A. and France, so far as I know, the system followed is more or less the same as that in vogue in India to-day. It must be taken into account, however, that the problems of India are different from those of the U.K., U.S.A. and France. Economic development in those countries took place outside the sphere of government activities. To the extent there has been nationalisation in the U.K. and France, there have been public corporations and their budgets are presented in the usual commercial way. For non-economic activities there is nothing particularly wrong with the present budgetary system. A proper comparison would be really with the budgetary system in the U.S.S.R., of which we have practically no knowledge.

Although American governments do not participate to any appreciable extent in economic activities, the question of having "functional" budgets, as described above, or the ordinary sort of budgets, has been debated for some time in America. The ordinary sort of budget has been spoken of in these debates as the "line" budget. The technical word there for the "functional" budget is "performance" budget. In 1947, the U.S. Congress created a Commission, called the "United States Commission on Organisation of the Executive Branch of the Government", better known as the "Hoover Commission", as ex-President Herbert Hoover was its Chairman. The Hoover Commission recommended, among other things, that the budget and accounting processes should be on a "performance" instead of an agency basis.² So far as I know, this recommendation was not put into

² Paul Studenski and Herman E. Krooss, *Financial History of the United States* (McGrawhill Book Company 1952), p. 467.

operation anywhere except in the State of Maryland.³

I recommended in 1953 that a start may be made in a small unit in India, with a "performance" type of budget and results watched. A "performance" budget would, no doubt, lead to economies of the right type and so to a better utilisation of the resources available.

Professor Mahalanobis has excluded items like "General Administration", "Police", etc. from his categories, which pertain only to economic, social and cultural activities. If Professor Mahalanobis' categories are followed, the budget would have to be sub-divided into three parts, as follows:—

- (a) General administration, police, administration of justice, etc.—the usual law and order functions;
- (b) Plan Budget—revenue section;
- (c) Plan Budget—capital section.

It might be difficult and perhaps unnecessary to work out sub-divisions between (b) and (c) above. There might be advantages in having the whole Plan Budget of the Central or of a State together at one place under the specified categories. These points, however, are matters of detail. The main point is whether a "performance" budget is preferable to the present "line" budget.

Conclusion. Democratic control would be rendered easier and more fruitful, and reappropriations easier if the present budgetary and accounts system is changed to the "functional" system adopted in drawing up the Five Year Plans. In that case, the Plan Heads, Sub-Heads and Detailed Heads, the Budget Heads, Sub-Heads and Detailed Heads and Accounts Heads, Sub-Heads and Detailed Heads will be identical.

³ O. K. Ghosh, *The Role of the Canadian and U.S. Government in the Promotion and Execution of Economic Development Schemes* (Government of India, 1953), p. 60 *et. seq.*

LAPSING OF BUDGETARY GRANTS

The Reserve Bank of India, in their Bulletins, publish a table relating to the "receipts, expenditure and public debt of the Central Government". If one turns to this table in the various issues of the Reserve Bank Bulletin, one notices a strange phenomenon as regards expenditure. The level of monthly expenditure of the Central Government, which is round about Rs. 20 crores, suddenly shoots up to about Rs. 50 to 60 crores in March (*cf.* Reserve Bank of India Bulletin, December 1956, page 1287). If one plots the figures of expenditure of various State Governments month by month in a graph the same phenomenon is exhibited. This is well known in government circles, and even among legislators, as the "March rush". To the extent that I have analysed the figures of public expenditure of various Governments in the United States and of the United Kingdom, I have found nothing analogous to this "rush" at the last month of the financial year. This "March rush" has been much debated within governments. Various Public Accounts Committees and finance departments have castigated this "March rush", but apparently without results. There have been the usual recriminations about this "March rush". Executive officers have often put the blame on finance departments for being tardy in sanctioning expenditure. Finance departments have replied back that many proposals come too late or in a half-baked manner. Whatever be the reason, there is obviously some lacunae in the budgetary processes which leads to this a mad rush at the end of the financial year. Many officers have expressed the fear that if the sums included in the budget estimates are not spent by the end of the year, they would lapse. Hence, they *have* to be spent. If there were a system whereby moneys did not lapse at the end of the year, then spending could be spread out more evenly, and perhaps more judiciously. For, "spree" spending is always liable to be suspected of being, at least to some extent, injudicious. So far as government expenditure goes, spree spending might mean

that the welfare of the people is not so well looked after as in a system where money is spent in a more judicious manner.

The above spree spending relates mainly to "revenue" expenditure, as the tables of the Reserve Bank of India Bulletin will show. To some extent, however, there is spree spending also as regards "capital" expenditure.

The question as to whether we cannot have a budgetary system where there is no lapsing at the end of the year, therefore, deserves consideration. If it is found that this is not possible then one would have to consider what measures, within the existing system, can stop spree spending.

Under Articles 112(1) and (2) and 202 (1) and (2) of the Indian Constitution, voting of funds in India is an annual procedure. Article 112 (1) and (2) reads as follows:—

Article 112 (1). The President shall in respect of every financial year cause to be laid before both the Houses of Parliament a statement of the estimated receipts and expenditure of the Government of India for that year, in this part referred to as the "annual financial statement".

(2) The estimates of expenditure embodied in the annual financial statement shall show separately—

- (a) the sums required to meet expenditure described by this Constitution as expenditure charged upon the Consolidated Fund of India; and
- (b) the sums required to meet other expenditure proposed to be made from the Consolidated Fund of India, and shall distinguish expenditure on revenue accounts from other expenditure.

Article 202 (1) and (2), which relate to the States, reads as follows:—

Article 202 (1) The Governor shall in respect of every financial year cause to be laid before the House or Houses of the Legislature of the State a statement of the estimated receipts and expenditure of the State for that year, in this Part referred to as the "annual financial statement."

(2) The estimates of expenditure embodied in the annual financial statement shall show separately—

- (a) the sums required to meet expenditure described by this Constitution as expenditure charged upon the Consolidated Fund of the State; and
- (b) the sums required to meet other expenditure proposed to be made from the Consolidated Fund of the State; and shall distinguish expenditure on revenue accounts from other expenditure.

(The provision is the same for all States).

Votes for money have thus to be annual, and there is no way to prevent lapse of funds within the present Constitution unless special Development Funds are created by statute. We might consider whether this is possible with reference to the relevant articles in the Constitution. The constitutional position is the same for both the Centre as well as the States, and hence, the conclusions as regards the Centre would apply equally to the States. Articles 114(3), 204(3) and 266(3) of the Constitution of India impose certain restrictions whereby no money can be withdrawn from the Consolidated Fund of India or of any State except under appropriation made by law, in the manner provided in the Constitution. The relevant articles are as follows:—

Article 114 (3). Subject to the provisions of articles 115 and 116, no money shall be withdrawn from the Consolidated Fund of India except under appropriation made by law passed in accordance with the provisions of this article.

Article 204(3). Subject to the provisions of articles 205 and 206 no money shall be withdrawn from the Consolidated Fund of the State except under appropriation made by law passed in accordance with the provisions of this article.

Article 266(3). No money out of the Consolidated Fund of India or the Consolidated Fund of a State shall be appropriated except in accordance with law and for the purposes and in the manner provided in this Constitution.

The Appropriation Acts, which authorise the appropriation of grants voted by the legislature, place in the hands of the executive a consolidated amount under each grant. A Development Fund can thus only be built up by appropriations from various Consolidated Funds and expenditure from these Development Funds might be non-lapsing for a certain number of years, as may be laid down by the legislature concerned from time to time. But such a proposal to render a portion of the grants non-lapsing would be opposed to the theory of annual democratic control, as laid down in Articles 114 (3) and 266(2) of the Constitution. It would also militate against the provision in the Constitution of the Contingency Fund (Article 267 of the Constitution). The object of this Contingency Fund is to meet unforeseen expenditure, pending authorisation of the necessary sums by the Parliament or State Legislature. This is a new feature in the India democratic set-up. It did not exist in the old days. Article 267 reads as follows:—

Article 267(1). Parliament may by law establish a Contingency Fund in the nature of an imprest to be entitled “the Contingency Fund of India” into which shall be paid from time to time such sums as may be determined by such law, and the said Fund shall be placed at the disposal of the President to enable advances to be made by him out of such Fund for the purposes of meeting unforeseen expenditure pending authorisation of such expenditure by Parliament by law under article 115 or article. 116.

(2). The Legislature of a State may by law establish a Contingency Fund in the nature of an imprest to be entitled “the Contingency Fund of the State” into which shall be paid from time to time such sums as may be determined by such law, and the said Fund shall be placed at the disposal of Governor or Rajpramukh of the State to enable advances to be made by him out of such Fund for the purposes of meeting unforeseen expenditure pending authorisation of such expenditure by the Legislature of the State by law under article 205 or article 206.

There is a still more difficult problem than the amendment of certain articles in the Constitution. Even if the necessary

Articles were amended, this would not facilitate matters. The creation of Development Funds means the setting aside of certain amounts by the Central and State Governments for the different Funds. This implies the locking up of money for future expenditure, a procedure which poor governments like the Central and the State Governments of India can hardly afford. It is true that the non-lapsing system exists in the U.S.A. But then governments there are much richer and they do not also go in for development expenditure on a large scale, which keeps down public expenditure. These two factors make it possible for them to allot certain sums in a non-lapsable manner. Also, in the U.S.A., legislative control is so detailed that the executive cannot commit themselves to spending money two or three years in advance unless budgetary provision exists. In the British and the Indian systems this question does not arise. A contract with a foreign supplier can be entered into, involving payments over a number of years, without the necessary budget provision covering these payments having been made. This is not possible in the U.S.A..¹

Mr. Ashok Chanda, the Comptroller and Auditor General of India has made the following suggestions regarding the budget:—

“The budget should continue to be compiled on the present basis but should be considered as only the budget plan to give the Parliament a broad picture of the Government’s scheme of expenditure, Demands for grants should be based on—

- (i) standing charges, including maintenance;
- (ii) expenditure on current projects; and
- (iii) a small provision for each new project. Supplementary demands should be presented as and when schemes mature sufficiently and are ready for execution”.²

The adoption of the above proposals would mean that one need not budget in a wild manner, as moneys could always be made available by means of supplementary demands.

¹ Samuel H. Beer, *Treasury Control* (Oxford 1956), pp. 44, 46-47, 49.

² *Central Government Audit Report* (Civil) 1955, pp. 37-38.

So far, it appears, the going in for a supplementary demand has been thought of as akin to committing a crime, if not a sin. Actually, in a Development State, and in the peculiar circumstances of an underdeveloped country like India, where estimating, involving supplies of equipment from abroad, is so difficult, supplementary demands, as and when necessary, should properly be a normal feature of parliamentary procedure. Thereby, parliamentary control would be better ensured and the *raison d'être* for spree spending removed.

Another point made by Mr. Ashok Chanda is that unless the head of the Ministry is himself responsible for financial matters there would be no identity of interests as regards the speedy execution of schemes, on the one hand, and economy in their execution, on the other. He has suggested, therefore, internal financial advisers and a continuous review within departments of progress of expenditure.³ In other words, he has suggested the adoption of the present-day British system in its entirety.

It seems to the present writer that best results can be achieved only if the British system is adopted completely. From recent newspaper reports (January 1957) it appears that Mr. T. T. Krishnamachari, the Indian Finance Minister, will be trying out a new system of "attached financial advisers" in the Centre. That is to say, these financial advisers would be working in close co-operation with the Ministries to which they would be attached, but would continue to be subordinate to the Ministry of Finance. Mr. Krishnamachari's reform would, therefore, be half-way between the old system and the British system advocated by Mr. Chanda. As we have seen, a great variety of systems is possible, and it is quite likely that Mr. Krishnamachari's reform would produce the desired results. Much would depend, however, on the officers chosen.

So far as the States go, there does not appear to be any talk of any reform anywhere.

Conclusion. There is at present a phenomenon both in the Centre as well as in the States known as the "March rush". Two to three times more than the normal monthly amount

³ *Ibid.*, p. 32.

is spent in March. As is well known, all spree spending is somewhat erratic. The purposes of a Welfare State are not likely to be served best by spree spending. Also, spree spending depends very much on the whims and energy of different officials. One way of stopping spree spending would be to have Special Development Funds wherein moneys would be non-lapsing. There are constitutional bars to the creation of such Funds. The Contingency Funds provide for the grant of sums in emergencies. The voting system of moneys under the Indian Constitution has to be annual. Also, even if the Constitution were amended, enough funds would not be available to build up different Development Funds. The best way to get out of the difficulty would seem to be to have financial advisers within the different departments to scrutinise expenditure closely every month, and to have recourse to a greater extent than at present to supplementary demands being placed before legislatures. The latter would mean increase in the hours of legislative business. A recent (1957) reform of Mr. T. T. Krishnamachari seeks to meet the problem as well as ensure economy and less antagonism between departments by a system of attached financial advisers. This system might work, but in any case, a greater recourse to supplementary demands would seem to be the real answer to the sprees of March.

THE PLANS AND THE BUDGET

In the last chapter we saw the perplexity of executive officers in the matter of framing budget estimates, especially as regards capital works. They are not sure how much they would get from year to year. Hence, it is somewhat difficult for them to frame their programme of works. One may ask, does not the Plan provide the necessary nexus? Once a scheme is provided for in the Plan and the yearly ceilings of expenditure laid down, what is the difficulty? Unfortunately, the nexus between the Plan and the Budget is still, it appears, in a somewhat nebulous state. Apparently the finance departments see that the scheme in question is in the Plan. If it is not there, then it is quite possible that sums may not be available. But there is no guarantee that sums to the full amount of the yearly ceilings as shown in the Plan for the particular scheme will be sanctioned by the finance department. Nor is there any necessity to put all schemes in the Plan. Some development schemes outside the Plan are also carried out.

We cannot go to many other countries to find out what they are doing in the matter. The economy of the U.S.A. is, in reality, very much a planned economy, but the planning is done practically wholly by private enterprise. In the U.K. and France also, the pattern of the "mixed economy" is different from that in India. Entrepreneurs have developed industries in those two countries, and the governments are now only taking some of them over. In India, due mainly to the lack of entrepreneurs in the past, and their paucity in the present time, Governments have had to take their place. In the U.S.S.R, China and in the countries of East Europe, conditions are somewhat analogous to those in India, but we have very little detailed information about them. The general pattern, however, is known. The financial plan is part of the national-economic plan. After the national economic plan has been approved by Governments, it acquires the force of law and it is obligatory for ministers and

enterprises.¹ In India the Plans are laid before Parliament and the State Plans before the State legislatures. The approval of the Parliament and of the State legislatures, however, do not give these plans the force of law. In the case of budgets, the legislatures have to pass definite appropriation acts giving the budgets the force of law. There is no similar provision in the case of Plans. There is no provision in the Constitution for a Planning Commission or for the drawing up of Plans. There is an item, No. 20, "Economic and Social Planning" in the Concurrent List of the Seventh Schedule of the Indian Constitution. This item, although very wide, can be held to cover the formulation of Plans by the Centre. At present, however, the Plans are being presented to Parliament in a very general way without any aim of legislative sanction being given to them. It is a matter for consideration whether there should not be the sanction of law behind these Plans once they are approved by Parliament. At the present moment this is not necessary, as compliance is secured by the personal relations between the Ministers in the Centre and the States, all of them members of the Congress Party, under the banner of which India marched to freedom. It is by no means impossible to visualise a different state of affairs. In fact, it would only be prudent to assume that things might be different when the "children of the revolution" are no more with us, and to forestall difficulties. If machinery is secured to give the Plans, both of the Centre as well as of the States, the sanction of law, then it can be taken that necessary funds would be available year by year. This might be oversimplifying matters, but it might at least prevent extravagances in planning. The Governments concerned will then have to find out the resources. There might be an annual review of the Plans, which would be laid before the different legislatures, and this would indicate what the revised annual figures for the various years in the five-year period would be. This annual review report would also then have to have the force of law, so that in any subsequent year, after the first year in the Plan period, if annual ceilings are

¹ A. Kursky, *The Planning of the National Economy of the U.S.S.R.* (Moscow, 1949), p. 167. (as regards the USSR).

changed, the revised ceilings will have effect. These annual Plan ceilings would be by way of maximum limits. It is not necessary that budget provisions should be made up to the full annual ceiling figure, although that should be the normal convention. But it is necessary that the ceiling figure should not be exceeded except with the approval of Parliament or the legislature concerned. Within each annual ceiling, budget provision may be made by the finance department concerned according to mutually agreed estimates of what would be actually required. This would be on broad considerations. Within such provision, the financial adviser-cum-chief accounts officers and officers under them would have full powers of expenditure sanction in accordance with the powers delegated to them.

Where details have not been worked out a token provision may be made as suggested by Mr. Ashok Chanda (referred to in Chapter 4). When funds are required, advances may be made from the Contingency Funds, subject to the annual Plan ceiling not being exceeded, and a proper grant under the head concerned voted later by the legislature.

Good business firms would run more or less on the above lines. Where capital goods are concerned estimating for a long period is necessary. The firm would estimate both the resources which may be available and the expenditure to be incurred, for the period as whole as well as for each year, and would try to see that the expectations are realised. If the analogy of a good firm is adopted, then governments also would have to be as definite as possible about the raising of the required resources over the 5-year Plan period so that executive officers are not in doubt about funds being made available.

In the U.K. there is the practice of what is known as the "economic budget" being presented to the public along with the ordinary budget. The following two tables would show what details are given in the "economic budget" in the U.K. :—

National Production

Salaries, wages and other emoluments.
Profits.

Rent.

Residual error.

Domestic revenue including depreciation and appreciation of stocks.

Appreciation of stocks.

Foreign revenue.

Gross national revenue at factor cost.

Plus indirect taxes.

Minus subsidies.

Gross national production at market prices.

Expenditure of the Community

Expenditure on consumption.

Expenditure by the Public authorities on goods and services.

Gross investment.

Exports.

Imports.

Gross national expenditure at market prices.²

Such an "economic budget," in the words of the French economist statesman, Pierre Mendes-France, explains to the general public "the need for and significance of the measures taken and the sacrifices called for".³ If the presentation of an "economic budget" becomes a feature of the Indian system, it would make things more intelligible to the lay public, even if it does not become pleasanter thereby to pay more taxes. It may be mentioned, in this connection, that periodical economic reports are also remitted by the President of the U.S.A. to the Congress under the terms of the Employment Act of 1946.⁴

Conclusion. There does not appear to be any constitutional sanction at present behind the Plans of the Planning Commission. This has created no difficulty so far, due to certain special circumstances which may not always exist. If steps are taken to give Plans the sanction of law once they are

² *Economic Survey of the U.K. for 1952.*

³ Pierre Mendes-France and Gabriel Ardant, *Economics and Action* (Heinemann-Unesco 1955), p. 126.

⁴ O. K. Ghosh, *The Role of the Canadian and U.S. Government in the Promotion and Execution of Economic Development Schemes* (Government of India, 1953), pp. 57-58.

passed by Parliament, this might have other desirable effects also. For it would then be incumbent on all governments to fulfil the Plans on the resources as well as on the expenditure side. Planning may be more careful. And all this would give the required assurance to executive officers that necessary funds would be forthcoming in due course. At present, the question as to what they would get by way of money in the next financial year provides an element of uncertainty. This uncertainty can be overstressed. However, some uncertainty doubtless exists. It cannot be wholly eliminated. For, it may not always be easy to realise all the resources estimated in an underdeveloped country. It may, therefore, not always be possible to give all the money year by year, as originally planned, for different schemes. However, if Plans on their financial side are considered to be long-period budgets, then there is no reason why efforts would not be made by governments to fulfil these long-term budgets in their entirety. In other words, while a Law and Order state could do with annual budgets, for a Development State a five-year budget, with annual revisions, would seem to be a better method of ironing out operational difficulties.

If an "economic budget", as in the U.K., accompanies the ordinary budget, this would help in explaining the significance of the measures taken and the sacrifices called for.

SECTION III
EXPENDITURE CONTROL

METHODS OF EXPENDITURE CONTROL

Problem. Is there, or are there, problems as regards the methods of expenditure control adopted in Indian governments? If so, have they been precisely formulated? There has, of course, been vague dissatisfaction in the minds of many administrative officers about the officials of finance departments. These latter officials are said to block and delay every proposal and contribute to the general frustration felt by executive officials. Dr. Appleby has some pertinent comments, but unfortunately his reports, although not secret, have not been made available to the general public. Hence, I am not drawing upon Dr. Appleby's valuable criticisms.

The Planning Commission, in their first report, had something to say about expenditure control. They said:—

“A plan of economic development necessarily postulates substantial increase in public expenditure. The importance of securing economy and sound financial control which is already generally recognised is, therefore, further emphasised by the needs of national planning. The objects of financial control are to ensure (1) that no wastage of resources occurs, (2) that public money is not misapplied, and (3) that for the money spent adequate results are obtained. Within the administration the responsibility for ensuring that these conditions are observed rests equally upon the administrative authorities and upon finance departments although, necessarily, the latter have special duties to discharge. There is need always for close co-operation at each level between the financial and the administrative authorities so that, if any difficulties are encountered, they can be removed through personal consultation at an early stage in the formulation of a proposal and before commitments are entered into. Financial procedures which, on the one hand, secure adequate control and, on the other, avoid too

great an interference in carrying out their own programmes, are essential to the efficient execution of the Five Year Plan. The subject, however, requires careful consideration and specific remedies can only be proposed after detailed study with reference to local procedures and problems. We, therefore, suggest that both in the Central Government and in the States the existing arrangements should be reviewed by the finance departments in co-operation with the Planning authorities".¹

It will be seen that the Planning Commission's assessment was very general. All that the Planning Commission said in the First Five Year Plan is that the procedures require re-consideration so as to ensure adequate control on the one hand, and the avoidance of unnecessary interference in the carrying out of programmes by executive officers on the other. There is nothing about expenditure control in the Second Five Year Plan. We might then examine our system, compare it with systems in a few other countries and reason out whether our methods require any change or not, the basic idea being to ensure the maximum possible financial control in all important matters with the maximum possible delegation of powers to executive officers.

The second question is : How far is expenditure control related to democracy. This is a very wide question. Expenditure control has obviously a direct link with democracy, in the sense of the welfare of the people at large. For if there is a better outturn per rupee, this will be to the benefit of all concerned. In a welfare state, the old Gladstonian doctrine of the saving of candle ends should not be the real guiding philosophy of officials of finance departments. As Sir Edward Bridges has pointed out in his Stamp Memorial Lecture, 1950, the real function of finance departments to-day is to ensure that money is spent in the best way to achieve certain declared objectives, *i.e.* to ensure the proper employment of resources.² In seeing that money is used in the most economical manner representatives of the legislature can obviously do a lot. Officials in most countries tend to

¹ *The First Five Year Plan*, pp. 123-124.

² Sir Edward Bridges, *Treasury Control*, (University of London, Athlone Press, 1950), p. 9.

live apart from the people at large, especially higher officials. A whiff of fresh air, the common touch, always restores a sense of balance and a sense of proportion. The officials provide the "know-how", but the common touch, and the knowledge as to what the people really want, should be provided by public men. In this connection, the former British Prime Minister, Lord Attlee, has something very interesting to say. In an article on civil servants, Ministers, Parliament and the public, he observed:—

"Equally, the Minister is more in touch with the ordinary man and woman than the civil servant. Something which seems quite reasonable to the middle-class professional may not go down with working people. I always found the late George Tomlinson a good touchstone in these matters. I would say: 'Well, what do you think of this, George?' He would answer: 'It looks all right but I've been trying to persuade my missus about it for the last three weeks and I can't convince her.' It is the business of the Minister to bring in the common touch".³

It is possible that even the Minister might lose the common touch. Legislators, who have no executive responsibilities, should not.

How best, then, can the common touch be provided in estimating future expenditure? This is a problem which we will have to consider as it is most intimately connected with democracy.

U.K. In the U.K., and in Commonwealth countries in general, practically the same methods of expenditure control are followed. The central point in this control system in Britain is its famous Treasury. The British Treasury is descended from the medieval Exchequer.⁴ Its powers increased bit by bit, until, in 1877, at the time of the appointment of the Hon. F. A. Stanley (later Sixteenth Earl of Derby) as Financial Secretary to the Treasury, Gladstone commented:—

³ William A. Robson, *Civil Service in Britain and France* (The Hogarth Press, London, 1956), p. 21.

⁴ Samuel H. Beer, *Treasury Control*, (Oxford, The Clarendon Press, 1956), p. 1.

"Stanley is clever, but can an heir to the Earldom of Derby descend to the saving of candle ends, which is very much the measure of a good Secretary to the Treasury?"⁵

In 1899, statutory powers were given to the Treasury over most new ministries, as follows:—

"The Minister may appoint such secretaries, officers and servants as he may with the consent of the Treasury determine"

Treasury control is exercised as follows:—

- (a) Control over estimates at the time of the preparation of the budget;
- (b) necessity for Treasury authority before any new service or branch of expenditure can be started and for any increase in staffs or pay.⁷

At the time of the framing of budget estimates, the Treasury check is very broad. Hence, detailed control by the Treasury, before any money is actually spent, is necessary.⁸ Before 1921 the post of Accounting Officer in each Department, who was responsible for financial questions, was usually held by a Finance Officer. These Finance Officers were regarded in the nature of "outposts of the Treasury".⁹ In 1921 the position changed. The Permanent Secretary of the Department became the Accounting Officer, but he retained a Principal Finance Officer on his staff. Sir Edward Bridges says that when this reform was introduced it was for several years the subject of some controversy.¹⁰ He also says:—

"The essence of the arrangement is that it ensures that responsibility for policy, and for financial consequences of that policy, go hand in hand; and that finance is not something troublesome and

⁵ Sir Edward Bridges, *Treasury Control* (University of London, 1950), p. 6.

⁶ Quoted in Bosworth Monck, *How the Civil Service Works* (Phoenix House Ltd., London, 1952), p. 65.

⁷ Sir Edward Bridges, *Op. Cit.*, p. 7.

⁸ Samuel H. Beer, *Op. Cit.*, p. 25 *et. seq.*

⁹ Sir Edward Bridges, *Op. Cit.*, p. 10.

¹⁰ Sir Edward Bridges, *Op. Cit.*, p. 11.

inconvenient, no doubt, but which need not be thought about until after policy has been settled".¹¹

This reform in the British system is linked with the name of the then Permanent Secretary to the Treasury, Sir Warren Fisher, who said that "the Heads of Departments should work together as a team in the pursuit of economy in every branch and every detail of the public service" and that "Treasury Officers should not assume for themselves a peculiar righteousness and a corresponding omniscience".¹²

The Treasury has such prestige in Britain that at one time, in the days of the powerful Lord Palmerston, it stopped a small war by refusing to agree to the required expenditure.¹³

For parliamentary checks on budget estimates there are what are known as Select Committees on Estimates. In the earlier days, these Estimates Committees apparently did not live up to expectations. Sir Gilbert Campion expressed the opinion that they did not have sufficient knowledge and that the Treasury could not help them much as the budget estimates reflected the Treasury's own ideas on various matters.¹⁴ Later on, however, there was some streamlining in the work of the Estimates Committees. Each such Committee was broken up into three or four sub-committees, meeting once or twice a week. It was found that, other factors being equal, the sub-committees covered three or four times as much ground as a single group body and probably more.¹⁵ Sir John Wardlaw Milne, M.P., said about these sub-committees that "all the documents which were coming before the Sub-Committee on any day had been read by each Member of that Sub-Committee".¹⁶ He contrasted this with his experience in the Estimates Com-

¹¹ Sir Edward Bridges, *Op. Cit.*, p. 11.

¹² Sir Edward Bridges, *Op. Cit.*, p. 11.

¹³ C. K. Webster, *The Foreign Policy of Palmerston* (London 1951), pp. 388-389.

¹⁴ Basil Chubb, *The Control of Public Expenditure* (Oxford 1952), p. 208.

¹⁵ Basil Chubb, *Op. Cit.*, p. 217.

¹⁶ Basil Chubb, *Op. Cit.*, p. 221.

mittee, where "very few Members knew anything about what was going to happen on that particular day at all".¹⁷

India. In India the British pattern is followed, except for one great difference. The difference is that our system is still that followed in the U.K. before Sir Warren Fisher introduced his great reforms in 1921.* That is to say, our finance officers are members of the finance departments and not officers of the administrative departments concerned. The head of a department has no formal responsibility for financial or accounting matters. Hence, he does not have to bother about economy and the best possible utilisation of resources, if he does not want to. Even in the Railways the Financial Adviser-cum-Chief Accounts Officer is responsible for finance and accounts and not the General Manager. Otherwise, the Railways approximate a little to the British pattern. During World War II, financial advisers were attached to the Central Supply Department at various echelons. They were, however, not subordinate to the head of the Supply Department. Later on, finance officers have been attached to big departments or groups of departments in the Government of India, but their allegiance has been to the finance department. In most States even this measure of reform has not been undertaken.

There has, for a long time, been an analogue of the Estimates Committee in the Centre. Formerly it used to be known as the Standing Finance Committee. Now it is known as the Estimates Committee. It has done very useful work. But the sub-committee system has not apparently been tried out, at any rate not extensively. In most States this form of democratic control is in its infancy.

U.S.A. In the American governmental pattern there is no system of prior financial approval to proposals.¹⁸ The Congress and the State legislatures pass laws and vote funds. The relevant Appropriation Acts are very specific. Once sums are voted, money is spent according to these detailed appropriations by the head of the Department of Bureau concerned. He has no external financial adviser.

¹⁷ Basil Chubb, *Op. Cit.*, p. 221.

¹⁸ Samuel H. Beer, *Treasury Control* (Oxford 1956), p. 25.

He is in supreme control of all financial and accounting matters. He might, if he so chooses, delegate this watch-dog function to a subordinate of his, but that is entirely his own concern. He is not required to do so. Wherever I explained the Indian (which is the U.K. system) to American officials in various Departments and Bureaus in the U.S.A., they held up their hands in horror. It was impossible for them to conceive how work could proceed with a person from outside the Department and his myrmidons constantly looking over the shoulder and nagging. This seems to show that human nature is malleable enough for many systems (if not any system) to be workable, provided they have had the sanction of time.

In the American system, however, there is constant review by "budget examiners." For instance, there is a Bureau of the Budget, directly under the control of the President, in the American Federal Government. The officials of the Bureau of the Budget sit with the officials of different Departments and Bureaus throughout the year and the final budget estimates are prepared only with their concurrence and approval. In other words, the budget examiners check that the estimates are supported by adequate blue-prints and detailed plans of action, at one stage. There is no splitting up of the check in two stages as in the British system. Once this is done, the proposals go to the legislatures where they are again scrutinised by aggressive Congressional or State legislative committees.¹⁹ As the appropriations are in great detail, and as there has been thorough check of the estimates beforehand both by the budget examiners and by legislators, who have adequate expert staff, further check by men of a finance department, a department external to the spending departments, is not necessary.

U.S.S.R. There is very little information about the methods of financial control in the U.S.S.R. It appears that in factories and production units at any rate, what is known as "ediny nachaly", or unified control, is favoured. Thus, for instance, in Kolkhoz organisations, the Chairman of the administration is responsible for everything. But he has by his side a Chief Book-keeper. The Chief Book-keeper

¹⁹ Samuel H. Beer, *Op. Cit.*, p. 63.

looks after, not only accounts and finances, but is also supposed to have a say in the control of work achievement. He supplies the State Bank with progress reports, on which the amounts of quarterly cash advances are determined. He also plays the leading role in the organisation of "socialist competition."²⁰

It appears from an indirect reference in a well-known Soviet text-book that there is internal financial control.²¹ It also appears that there are "budgetary commissions" in the Soviet system.²² Also, that the budgets of local bodies are scrutinised by workers Deputies.²³ These budgetary commissions and other supervisory bodies of legislators must be functioning more or less in the same manner as the Estimates Committees and their Sub-Committees in the U.K., but precise information is lacking.

A Model. Suppose there is a firm consisting of a great number of shareholders. How will the firm manage its affairs? It will have to elect a Board of Directors. It is possible, as in human affairs in general, that the Board of Directors may themselves float the company and get themselves elected. However, the shareholders are bound to have a say in the election in the Board of Directors and in the affairs of the company, and the more alert the shareholders, the greater their participation in these affairs. The Board of Directors is thus a committee of the shareholders. It will not be possible for the Board of Directors to manage day-to-day affairs sitting in committees. They will have to delegate powers to a Managing Director. Suppose the company expands its activities. It will then become impossible for the Managing Director to look into everything. He will have to have different kinds of managers under him, some functional, some regional. How would finance come into the picture? If the Managing Director is particularly interested in finance, he might spend more time on this matter

²⁰ Alexander Vucinich, *Soviet Economic Institutions* (Hoover Institute Studies, Stanford University Press, 1952), p. 115.

²¹ N. N. Rovinskii, *Finansovaya Systema USSR* (Moscow, 1952), p. 153.

²² Rovinskii, *Op. Cit.*, p. 147.

²³ Rovinskii, *Op. Cit.*, p. 148.

than on anything else and may specialise in it. He will, however, have to have subordinates to do much of the detailed work for him, and certainly an internal accounts branch. He will also have to have some sort of internal check or audit branch. Even if he is not interested very much in the financial side of things, he cannot divest himself of his responsibility in financial and accounting matters. The Board of Directors will consider him as irresponsible and incompetent if he does so. He might, however, delegate most of such functions to some one who has an aptitude for these matters. If there are very many matters which the company looks after, then different members of the Board of Directors might specialise in different fields. They are almost certainly likely to do so, or else leave matters entirely to the Managing Director. Let us assume that the Managing Director is not very much interested in finance. He appoints, therefore, a finance officer. Now this finance officer cannot divest himself from accounts in any rational system, as in a good firm finance and accounts have to be indissolubly linked. Also, a finance man is responsible for a certain measure of internal check in monetary matters.

Not only a good firm, but also a good club and large organisations would more or less be run on the above principles.

The Model as compared with system in different countries. In the United Kingdom the practice is more or less in accord with the model described above. The Company consists of the people. Parliament is the Board of Directors, and the Cabinet, the Managing Director and the executive machinery of the firm. Each director specialising in certain matters is the equivalent of various Parliamentary Committees, like the Estimates Committee, and their Sub-Committees. The Head of a Department in the United Kingdom is not divested of financial, accounting and internal audit responsibilities. He is the Accounting Officer as well as the Permanent Secretary. Under him he has a man who specialises in finance, accounts, etc. Thus, the model and the U.K. practice are more or less the same.

In the United States the firm consists of the people of the United States. The Boards of Directors are the various

legislatures; for instance, the Congress. The Managing Director, the President or the Governor of the State, is elected direct by the firm. That is to say, by the people. The various Congressional and legislative committees are equivalent to individual members among the Board of Directors specialising in different subjects. The Managing Directors, *i.e.* the President or the Governor, have their own separate organisations for the management of the financial side of things. Generally the organisation is known as the Bureau or the Budget. The President has such a Bureau. Each executive agency under the President or the Governor is wholly responsible for finance and accounts and a department or bureau has some one specialising in these matters under him. Thus, the American system also follows the model.

There are, however, important differences between the British and American systems. How then can it be said that they both follow more or less the same model? The difference lies in the nature of control by the Board of Directors in the U.K. Much more latitude is given in the matter of committing the firm there to future expenditure.²⁴ For instance, in the British system, although voting of funds by Parliament is annual, the executive, acting in consultation with the Treasury, can make long-term commitments like contracts, etc.²⁵ In the U.S.A. this is not possible, as Congressional and legislative control there, through Committees, is much more detailed and aggressive.²⁶ Also, in the American system, funds are not always lapsable at the end of the year. It follows, therefore, that the American budget has to be worked out in great detail. Once, therefore, the budget estimates are worked out, the head of the department or of the bureau has merely to incur expenditure as laid down by statute. He has no need whatsoever of getting the "financial approval" of any one. He merely has to delegate the financial and accounting functions to some one who may be doing other things also. In other words, finance and accounts are indissolubly linked with administration here.

²⁴ Samuel H. Beer, *Treasury Control* (Oxford, 1956), p. 55.

²⁵ Samuel H. Beer, *Op. Cit.*, pp. 46-47.

²⁶ Samuel H. Beer, *Op. Cit.*, p. 63.

From the meagre information we have about the Soviet system, as given above, it seems that it approximates more to the American than the British system. It follows, however, the model.

How does our system compare with the model? We have the Board of Directors, the Parliament and the legislatures. The executive government is equivalent to the Managing Director. We also have various committees of the legislatures, equivalent to different members of the Board of Directors specialising in different affairs. We are still a newly independent country and specialisation by different members of the Board of Directors in different matters is in its infancy. So far, however, the model is more or less followed. When we come to the Managing Director (the executive), however, there is a departure from the model in essential detail. The Managing Director is split into two—the administrative and finance departments. The head of an administrative department is not responsible for financial or accounting matters, or internal financial check. Thus, if one of his subordinates spends money in going out on tours to attend festivals or cricket matches then the head of a department may or may not reprimand him. Generally speaking, he waits for an outside authority, the audit people, to raise such points before he takes serious notice of them. He does not ordinarily regard such matters as coming within his functions. Similarly, he may or may not be interested in the finances of his concern. Whether things are being run in the most economical manner or not is a matter for the finance department. He may or may not have a financial adviser sitting next to him. Generally speaking, in the States, he does not have one. Therefore, economy and proper check as regards financial matters are, strictly speaking, outside his domain. This seems a strangely unbusinesslike procedure. One may then ask, how has the system worked so long? The answer is, as we have seen above, any system will work. Human nature is so malleable that it adjusts itself to many circumstances. For instance, politically, there have been aristocracies, oligarchies, democracies, slave-holding societies, etc. Barely a dozen years ago, the despotism of the Indian Princes existed side by side with the half-democracy of British India. The despotism in the various Indian States worked, some better

than the others. The question, therefore, is not whether a system works, but whether it works the best. For instance, a Board may run a firm and make a profit of 2 per cent., while another Board of Directors may run the same firm and may make a profit of 10 per cent. One may run a club and there might be no activities whatsoever in it and it might be financially deficit, while with the same personnel a club may be run at a profit and to the happiness of all. A project can be executed at Rs. 100 crores or at Rs. 80 crores. It is possible that those who execute the project at Rs. 100 crores may say to people: "Look, what are these people, who are constantly carping, saying, 'Here is a magnificent thing which we have done.'" The answer may be: "Yes, you have done it at Rs. 100 crores instead of Rs. 60 crores. If you had allowed us to have our way, we would have done it at less cost, and perhaps more quickly. And we would have had money for something else." Whether we have any organisation which can prove that instead of spending Rs. 100 crores in, say four years for a project, other methods would have involved only Rs. 80 crores in three years, is another matter. The main thesis is that we might take a leaf from the experience of advanced civilised countries, whenever circumstances so warrant.

As between the British and the American systems, the British system might suit us better. Our constitutional system is such that funds lapse at the end of the financial year. Our administrators have wide powers as regards committing Governments to future expenditure, like their British counterparts. If we are to follow the American system, then not only would funds have to be made non-lapsable, but we must have also enough funds to make definite appropriations for longer periods than a year. Also, the budget estimates would have to be a carefully and precisely framed, including costs on account of machinery, etc. imported from abroad, if "prior financial approval" is to be done away with. Some of the difficulties in adopting the American pattern can be overcome, although one should not underestimate the conservatism of civil servants and their subconscious and conscious desires to thwart every kind of change. Some other difficulties, however, are more real. One, as mentioned above, is that there may not be enough

funds going round for the adoption in India of the non-lapsing budget system. Also, it may not be possible in India to frame budget estimates to the degree of accuracy possible in the U.S.A. In the U.S.A., firm dates can be obtained from contractors and suppliers of machinery. In India, as is well known, delivery dates are rarely very firm as plant and machinery are often obtained from abroad and there may be circumstances beyond our control. Another point is that in the U.S.A. the government has more or less kept itself out of the sphere of economic development. Hence, their problems as regards the framing of accurate budget estimates are less difficult than ours. A study of the difficulties experienced and the system in vogue in Soviet Russia and China may be more helpful than even studies in the U.K. For, in the U.K., nationalisation has meant the taking over of going concerns. In Soviet Russia and in China, however, they have had to work from scratch, more or less as we are doing in India.

Conclusion. It seems advisable to adapt our machinery of financial control more to the present-day British pattern, and also to strengthen the various Estimates Committees and their Sub-Committees. How best can all these be done? These points are considered in the next chapter.

CHAPTER 7

THE ESTIMATES COMMITTEE

We are in a fortunate position in many matters. For some time to come all that we have to do is to find out what has been done in advanced countries and adapt their experience to our requirements. In other words, we have to be intelligent and flexible imitators, however unpleasant this may sound. Innovation in a big way would perhaps come at a later stage when we have come abreast of the leading nations of the world, though the earlier it comes, the better. Of course, one cannot imitate blindly. Like the growth of knowledge, intelligent mimesis (this is a better word than imitation) requires a reasoning, questioning, experimental mind.

So far as our financial system is concerned, it would seem that if Warren Fisher's reform in the U.K. in 1921, is adopted, then we would be going one great step forward. A picture is presented below of the system as it would be, if this piece of reform is introduced.

In each public undertaking there would be a Financial Adviser-cum-Chief Accounts Officer. Similarly, groups of departments or large departments, both in the Centre as well as in the States, would have Financial Advisers-cum-Chief Accounts Officers. In such a system, the Financial Adviser-cum-Chief Accounts Officer would compile accounts from the initial accounts. He would also act as Financial Adviser. In giving his financial advice he would have knowledge, where necessary, of the actuals of expenditure. Financial control would, therefore, be more specific and accurate than it would be if one went mainly on one's hunches. Statistical knowledge about monetary transactions would also be readily forthcoming. Delays in payments, etc. should also be obviated by this system.

Such a system will not mean that there would be no Finance Department either in the Centre or in the States. There would be. These Finance Departments will not deal with details of schemes. This would be done by the

Financial Advisers-cum-Chief Accounts Officers. The Finance Departments will deal with general matters like rules for the control of expenditure and establishment, financial planning, raising of revenues, raising of loans, financial relations between different governments, and economic matters, including matters like coinage and currency, foreign exchange, etc. The Financial Advisers-cum-Chief Accounts Officers, under general delegations of powers, would have full authority to sanction expenditure within such ceilings as may be laid down. In large projects such powers may again be delegated by the Financial Advisers-cum-Chief Accounts Officers to their deputies and assistants, the specific limits being clearly laid down in each case.

In the U.K., when the Finance Officer disagrees with the Permanent Secretary, he can be overruled by the Minister and by him alone. Such a system has to be adopted wherever the theory is that the head of an organisation is responsible for all matters in his department, including finance. The Financial Adviser is thus under the administrative control of the Minister.

Mr. Ashok Chanda, Comptroller and Auditor General of India, has been making such proposals for some time. For instance, in a note appended to the Central Government Audit Report (Civil) 1955, Part I, he says:—

- (a) Financial scrutiny should be in two parts:
 - (i) Broad and overall scrutiny located in the Finance Ministry, and
 - (ii) Detailed scrutiny, at expert level, located within the administrative Ministries.
- (b) The administrative Ministries should be provided with internal Financial Advisers drawn from a panel of officers with financial experience (as approved by the Finance Minister). Technical advice should be made available by suitable adjustment in the strength of the present industrial Advisory and Development Wing under the administrative control of the Commerce and Industry. This organisation should be treated as a common pool for purposes

of giving technical advice to the administrative Ministers.

- (c) There should be de-concentration of authority in favour of Executive and Project Officers at all levels appropriate to their responsibilities and status.
- (d) Internal Finance Officers should be associated with the delegation of authority wherever necessary.
- (e) A schedule of sanctions should be prepared by every officer for submission to the authority immediately superior to him to enable a review of the manner in which delegated powers have been exercised.¹

There might be some, who, in spite of the suggestions thrown out by the consideration of a rational model in the last chapter and the experience of other countries, might say, "Why have financial control at all? Why not let officers do what they think to be the best, as is done in America? In any case, the financial and accounting officers only know procedures. And we do not see what really useful functions they perform."

It will be seen that some of the above objections are based on misconceptions. There is a very great degree of control in the U.S.A. by the budget examiners and legislative committees, in spite of the fact that American governments do not deal in any large-scale development measures. Experienced Indian administrators are against the lessening of control of either Parliament or of the Finance Departments, etc. For instance, Mr. A. D. Gorwala points out that work used to be done before in British days in India without so much fuss about the irksomeness of control by legislatures and of authorities like the finance departments, and audit.² Mr R. N. Banerjee, formerly Chairman of the Union Public Service Commission, has also expressed the view that "we must obviously be extremely chary of tampering with elementary and basic safeguards against the vagaries of civil

¹ *Central Government Audit Report* (Civil), 1955, Part I, pp. 38-39.

² *Statesman*, (Dak Edition), Wednesday, November, 28, 1956.

servants".³ There is an old adage in most tongues to the effect that a "a bad workman quarrels with his tools". Wherever there is a great outcry that things are not being done well because other people are to blame, there might well be some cause for *prima facie* suspicion that the complainants themselves are possibly blameworthy.

There might be something, however, in the complaint that finance and accounts officers know mainly procedure. This will be discussed further in Chapter 12.

The Estimates Committees of the Parliament and of the State legislatures go into the estimates before a scheme is finally sanctioned. The Financial Advisers-cum-Chief Accounts Officers would have obvious responsibilities towards the Estimates Committees, and, because of their intimate knowledge of both accounts and finance, it should be possible for them to discharge these responsibilities. In other words, they would provide the secretariat for the Estimates Committees and their Sub-Committees. Particular schemes would be studied by Sub-Committees of the Estimates Committees and the recommendations made by these Sub-Committees to the Estimates Committees, would, by convention, be generally always accepted.

Conclusion. For real democratic control the Estimates Committees would work, as far as possible, in Sub-Committees. These Sub-Committees would have Financial Advisers-cum-Chief Accounts Officers of the departments and public undertakings concerned functioning as their secretariat. This presupposes the existence of a system of Financial Advisers-cum-Chief Accounts Officers, on the British pattern, attached to large public undertakings, big departments and groups of departments. (In the U.K. these officers work under the departmental Ministers). Good financial control is thus a concomitant of democracy. In England democracy began with financial control. It is true that the Ministers are also representatives of the public, but it is only natural that in day-to-day activities they would be part and parcel of the departments. This has been the

³ *Statesman* (Dak Edition), dated 31st August 1956.

general experience of most countries and in all democratic countries some form of external check by legislatures has always been necessary. The necessity for such checks would perhaps be greater in India in the future, when the "children of the revolution" are no more with us, than it is at present.

SECTION IV
AUDIT

CHAPTER 8

IS AUDIT NECESSARY ?

Problem. Is audit necessary, from the point of view of democratic control, or from any other point of view? That audit is disliked is a well-known fact and there have been many critics of audit. Dr. Appleby's second report on the Indian administration, like the first one, has not been made public, but there have been criticisms of his views in the press, and some of his ideas have come out. Apparently, he does not like audit and considers it a necessary but pedestrian function of administration. The best way to answer the questions posed, however, would seem to be not to rely on an individual's *obiter*, howsoever eminent he may be, but first, to have a look at the systems in a few other countries; secondly, to think out from first principles, what system would be adopted by a good firm; and, finally, to draw conclusions on the basis of what good firms would do and the experience of other countries.

The United Kingdom. In the United Kingdom, the functions of the Comptroller and Auditor General were dealt with very specifically in the Exchequer and Audit Acts of 1866 and 1921. The Auditor General, like one of Her Majesty's judges, holds office during good behaviour. He is removable only by an address to the Crown from both Houses of Parliament. His salary and allowances, like those of judges, are charged to the Consolidated Fund; they are not votable. His functions are recognised to be of a judicial nature.¹ He audits the accounts of all departments and queries all questionable expenditure. He then takes them up with the departments concerned and if enquiry fails to clear matters, he reports them to the Public Accounts' Committee of Parliament. He is concerned mainly with the legality of the expenditure incurred.² But it has not been

¹ E. Hilton Young (Lord Kennet), *System of National Finance* (John Murray, 1936), p. 120.

² Lord Kennet, *Op. Cit.*, p. 122.

doubted that he is also a check on efficiency.³ The Comptroller and Auditor General is the right-hand man of the Public Accounts Committee and without him this Committee is at a loss. Private auditors have not been able to act in that helpful manner as the Comptroller and Auditor General, who can be called at any time by the Public Accounts Committee and questioned.⁴ The Comptroller and Auditor General is by no means universally liked. For instance, Mr. Bosworth Monck, the well-known civil servant-politician, thinks that the work of the Comptroller and Auditor General as Comptroller is one of supererogation.⁵ And, that his detailed check of actual expenditure together with that of the Treasury on proposed expenditure "are insurances of a fairly expensive kind, and certainly contribute to the average civil servant's sense of frustration, whatever positive good may be done".⁶

U.S.A. Strange as it may appear to many people, there was no real budgetary system in the American Government until 1921. Before that date each department had its own budget.⁷ The Budget and Accounting Act of 1921 provided, *inter alia*, for a Comptroller General. The Comptroller General, under this Act, has to investigate matters relating to the receipt and disbursement of public funds and report to Congress every expenditure or contract made in violation of the law. A General Accounting Office was created under the Comptroller General, to assume all the powers formerly exercised by the Comptroller of the Treasury.⁸ According to Messers Studenski and Krooss, the Office of the Comptroller General has failed to live up

³ Basil Chubb, *The Control of Public Expenditure* (Oxford 1952), p. 171.

⁴ Basil Chubb, *Op. Cit.*, pp. 145-146.

⁵ Bosworth Monck, *How the Civil Service Works* (Phoenix House 1952), p. 83.

⁶ Bosworth Monck, *Op. Cit.*, p. 84.

⁷ Paul Studenski and Herman E. Krooss, *Financial History of the United States* (McGrawhill 1952), pp. 323 *et. seq.*

⁸ Paul Studenski and Herman E. Krooss, *Op. Cit.*, pp. 324-32

to expectations. They say that it has become bogged down in extensive routine work and that it has also engaged itself in detailed pre-audits, thereby destroying much of its usefulness as an agency for independent post-audit and information and advice to Congress.⁹ The American Comptroller General possesses the power of making final settlement adjustment of accounts as well as the power to take advance decisions governing the settlement of accounts.¹⁰ If the Comptroller General disallows any expenditure, then what is known as "relief legislation" has to be passed before it can be incurred. The American system is such that annual audit reports by the Comptroller General are neither possible nor necessary there.¹¹ The American Congress passes detailed appropriation bills and the sums voted by them do not necessarily lapse at the end of each year. Hence, the Comptroller General's power of disallowing illegal expenditure is quite adequate. The American Comptroller General is an independent officer appointed by the President, with the approval of the Senate, for a term of 15 years, and removable only by impeachment or by joint resolution of the Congress.

In all the American States, except Oregon, Wisconsin and New Hampshire, there is an Auditor or Comptroller; in Oregon and Wisconsin, the Secretary of State is the ex-officio Auditor and in New Hampshire certain members of the executive council, appointed by the governor, serve as an Auditing Committee.¹² In all but four states, the Auditor is popularly elected. In these four states, he is chosen by the legislature.¹³

U.S.S.R. In the U.S.S.R. there is what is known as the Ministry of State Control.¹⁴ This was created in September

⁹ Paul Studenski and Herman E. Krooss, *Op. Cit.*, p. 326.

¹⁰ Samuel H. Beer, *Treasury Control* (Oxford 1956), p. 60.

¹¹ Samuel H. Beer, *Op. Cit.*, pp. 48-49.

¹² William Vernon Holloway, *State and Local Government in the U.S.A.* (McGrawhill 1951), p. 190.

¹³ William Vernon Holloway, *Op. Cit.*, p. 191.

¹⁴ Rovinskii, *Finan.sovaya, Sistema USSR* (Moscow 1952), p. 145.

1940 as a successor agency to the Soviet Control Commission. It exercises a general watch-dog role in respect of state property and the carrying out of administrative orders as well as regards cost accounting operations.¹⁵ Within this Ministry, there appear to be various Controllers General, one for each administrative unit, with adequate staff, including senior Controllers and junior Controllers. The junior Controllers are posted in organisations like factories. The control is twofold, preliminary and final. The first control consists in checking the legality of estimates, plans and expenditure allotments before payments take place, the second in auditing books for the purpose of unveiling unwarranted expenditure.¹⁶ The Controllers are everywhere, military districts, rail-roads, warehouses.¹⁷ There are similar Ministries of State Control in the different constituent republics. The Chief Controllers of these Ministries in these republics are appointed by the Council of Ministers of the republic concerned acting in concert with the Ministry of State Control of the U.S.S.R.¹⁸ The Ministries of State Control have very wide powers. They have the right of access to all administrative records, undertake audits on their own responsibility or draw on the audits of the Ministries of Finance as a basis for further investigation.¹⁹ Each Ministry of Finance has a Control and Inspection Board. This Board has "control stations" at different places. The "agents" in these "control stations" are trained in law, economics, finance and book-keeping. They have the right to audit the books of factories, etc. and report errors and infringements to the District Procurators. The main function of the District Procurator who is the "guardian of legality" is apparently to see that government orders are executed. In other words, he carries out an administrative audit. He is subordinate to the Regional Procurator, who is subordinate to the

¹⁵ Merle Fainsod, *How Russia Is Ruled* (Harvard University Press, 1954), p. 343; Alexander Vucinich, *Soviet Economic Institutions* (Hoover Institute Studies, Stanford University Press, 1952), p. 37.

¹⁶ Alexander Vucinich, *Op. Cit.*, p. 37.

¹⁷ Merle Fainsod, *Op. Cit.*, p. 343.

¹⁸ Merle Fainsod, *Op. Cit.*, pp. 343-344.

¹⁹ Merle Fainsod, *Op. Cit.*, pp. 344.

Union Republic Procurator, who again is under the Procurator General of the U.S.S.R.²⁰.

When offences are minor, the Ministry of States Control reprimands the officers. These reprimands are sometimes printed in the press. Sometimes a fine is imposed on the offender, up to the equivalent of three months of his salary. In more serious cases, the offender may be removed from office. In still more serious cases, he may be made over to the Procurator General's department for prosecution.²¹ Audits by the agents of the Ministries of State Control appear to be yearly and supplemental to internal audit.²² These auditors at their periodical inspections appear to have the right to issue instructions to the authorities whose accounts are being audited by them, to make them observe "financial discipline".²³ In addition to all this, there appears to be local audit commissions which are elected.²⁴ The whole spirit seems to be one of strict watchfulness. Molotov on one occasion said that if Plans are not verified as regards their fulfilment right up to the very end then they would be only Plans on paper.²⁵

The Soviet authorities lay great stress on what is known as "khozaschyot". There is no specific equivalent to this word in English. This is a combination of cost accounting, economic accounting and administrative evaluation. The purpose is to secure control over:—

- (a) use of materials, equipment, power and fuel;
- (b) application of the prescribed technological measures;
- (c) efforts to improve quality of production and
- (d) labour productivity.²⁶

The various Komsomol (Young Communist) units organise special "control brigades" and "control outposts" to help in "khozaschyot" activities.²⁷

²⁰ Alexander Vucinich, *Op. Cit.* pp. 37-39.

²¹ Merele Fainsod, *Op. Cit.*, p. 344.

²² & ²³ Rovinskii, *Op. Cit.*, p. 153.

²⁴ Alexander Vucinich, *Op. Cit.*, p. 61.

²⁵ Ronvinskii, *Op. Cit.*, p. 144.

²⁶ & ²⁷ Vuchinich, *Op. Cit.*, p. 10.

It is interesting to note that at one time Minister of State Control in the U.S.S.R is so prominent a politician as Molotov. He replaced Zhavoronkov, who was, relatively, an obscure figure. Zhavoronkov's predecessor was Merkulov, who was closely associated with Beria. During the Merkulov period the Ministry of State Control appeared to have worked closely with the secret police, but this has apparently been a temporary phase.

A Model. What would a good firm do? A good firm has to have an accounting branch so that its activities on the financial side are carefully recorded. There is no distinction between the activities of the finance departments, as is known in Indian governments, and accounts organisations, in good firms. Finance and accounts are inextricably intertwined. The accounts officers have also to conduct internal audit. Otherwise, by the very nature of things, the accounts may not be correct. So far, audit is an administrative responsibility essential for the good management of the firm. If the firm is private, no external audit is necessary. But if the money has been contributed by shareholders, then there is an external audit by a firm of reputable auditors. This firm audits the accounts of the company and its report is placed before the shareholders by the Board of Directors.

Application of the lessons of the model and of practice in other countries. We thus see from the model above that external audit is necessary as an independent check by the shareholders. Audit is here split into two, continuous internal audit for administrative purposes and external and audit for democratic control. In the United Kingdom, this model is followed in its simplicity. In the U.S.S.R. there is both internal audit as well as external audit and apparently the reports are also submitted to various legislative bodies. In the U.S.A. no annual reports of the British type are submitted by the Comptroller General, but on the other hand, he utilises the full power of the legislature in disallowing expenditure. The main conclusion which emerges is that audit is necessary in big organisations and that audit has to be divided into two parts : administrative audit for internal control and external audit for democratic control.

Conclusion. However irksome it may be, internal audit is necessary for good management. And, without external

audit democracy is unthinkable. In a democracy, the role of the Public Accounts Committee is very great. It cannot function without an independent audit of activities. This aspect is dealt with further in Chapter 11 below. Sidney Webb, in his inimitable way, summed up the arguments as regards the necessity or otherwise of audit by saying that "the fact that post-mortem examination does nothing to keep the patient alive is no proof that the existence of a system of post-mortem examinations does not prevent murders".²⁸

²⁸ Quoted in Basil Chubb, *The Control of Public Expenditure* (Oxford 1952), p. 196.

CHAPTER 9

SEPARATION OF ACCOUNTS FROM AUDIT

Problem. In recent years much has been heard about the separation of accounts from audit. Is this a technical question only, fit for disputation among civil servants, or has it any implications for democracy? If it has, what are the implications?

The System in India. Before we proceed to a discussion of the problems posed, the system which exists in India has first to be described. The constitutional position is laid down in Articles 148-151, which read as follows:—

“148 (1) There shall be a Comptroller and Auditor General of India who shall be appointed by the President by warrant under his hand and seal and shall only be removed from office in like manner and on the like grounds as a Judge of the Supreme Court.

(2) Every person appointed to be the Comptroller and Auditor General of India shall before he enters upon his office, make and subscribe before the President, or some person appointed in that behalf by him, on oath or affirmation according to the form set out for the purpose in the Third Schedule.

(3) The salary and other conditions of service of the Comptroller and Auditor General shall be such as may be determined by Parliament by law and, until they are so determined, shall be as specified in the Second Schedule;

Provided that neither the salary of a Comptroller and Auditor General nor his rights in respect of leave or absence, pension or age of retirement shall be varied to his disadvantage after his appointment.

(4) The Comptroller and Auditor General shall not be eligible for further office either under the Government of India or under the Government of any State after he has ceased to hold his office.

(5) Subject to the provisions of this Constitution and of any law made by Parliament the conditions of service of persons serving in the Indian Audit and Accounts Department and the administrative powers of the Comptroller and Auditor General shall be such as may be prescribed by rules made by the President after consultation with the Comptroller and Auditor General.

(6) The administrative expenses to the office of the Comptroller and Auditor General including all salaries, allowances and pensions payable to or in respect of persons, serving in that office, shall be charged upon the Consolidated Fund in India.

149. The Comptroller and Auditor General shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament and, until provision in that behalf is so made, shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States as were conferred on or exercisable by the Auditor General of India immediately before the commencement of this Constitution in relation to the accounts of the Dominion of India and of the Provinces respectively.

150. The accounts of the Union and of the States shall be kept in such form as the Comptroller and Auditor-General of India, may with the approval of the President, prescribe.

151. (1) The reports of the Comptroller and Auditor-General of India relating to the accounts of the Union shall be submitted to the President, who shall cause them to be laid before each House of Parliament.

(2) The reports of the Comptroller and Auditor General of India relating to the accounts of a State shall be submitted to the Governor who shall cause them to be laid before the Legislature of the State."

It will be seen that the Comptroller and Auditor General is completely independent of the executive. His duties and powers have to be prescribed under Article 149. They have

not yet been so prescribed. Hence, he exercises the powers and performs the duties as at the commencement of the Constitution. From Article 150 it will be seen that the Comptroller and Auditor General is responsible for keeping the accounts of the Union and of the States, although the President (that is, the executive) has a say in this. The Comptroller and Auditor General also submits reports relating to the Centre and to the States to the President and to the Governors, respectively. The various Accountants General in the different States are his officers and agents.

The Indian system is thus analogous to the British system except for one feature, *viz.* the Comptroller and Auditor-General is responsible for both accounts as well as audit. This which seems so natural to Indian administrators, has always struck foreign observers as strange. Even the British, used to things Indian, could not regard it otherwise. For instance, the Simon Commission observed:—

“A peculiar feature of the Indian financial system imposes on him a third function. The compilation of accounts and their audit are, except in provinces in which the Secretary of State in Council has declared otherwise, entrusted to the same agency the Indian Audit Department. The Auditor General is, therefore, responsible not only for audit, but also for the preparation of the accounts he audits. He is, in fact, the officer who is statutorily responsible for the compilation of the accounts which the Secretary of State is required to lay before both Houses for Parliament every year. The explanation of this anomalous combination of duties (a relic of the highly centralised system of administration which obtained in India before 1920) lies in the transitional nature of India's constitutional and administrative arrangements. Audit and accounts have already been separated in several departments of the Government of India and in the United Provinces, and the extension of this financial reform to other Provinces, which was strongly recommended

by the Muddiman Committee of 1924, has been hindered only by consideration of the cost involved".¹

Arguments in favour of Separation

(a) In the model which we considered in Chapter 8 we saw that in a good firm internal audit and accounts are combined with finance. The separation of these three is unthinkable there. It is the duty of the administrative head to be responsible for all that goes on within his organisation. He cannot wash his hands of finance or accounts or internal propriety in spending money. If the manager of a firm or the president or secretary of a club took such an attitude, he would be characterised at once as most irresponsible.

(b) If accounts and internal audit are departmentalised, then statistics of actual expenditure would be available to the administrative authorities much more quickly. At the present time, there is some duplication, as the departments keep some statistics themselves, which are, however, regarded only as rough and ready. Experience has shown that the difference between these rough and ready statements and the "actuals" compiled in the Accountant General's office can be substantial. It is difficult, therefore, to understand what purpose the departmental accounts really serve if discrepancies persist for a long period after the accounts of a year have been closed. Also, since the accounting organisations are separate from the administrative, there is a tendency on the part of the latter to restrict consulting accounts authorities to the minimum extent possible. In other words, accounting tends to be done more for the sake of accounting itself and the main use which the administration makes of accounts is during the preparation of the budget estimates, when the actuals of a certain number of years have to be inserted, to help in framing the estimates.

(c) At present the accounts authorities not only compile accounts, but they also authorise certain types of payments, including payments of a personal nature, like pay, leave salary, pension, etc. Delays in such cases cause friction and heart-burning, mainly because the administrative organisation and

¹ *Simon Commission Report*, Vol. I, p. 377.

the accounting organisation are separate. Relations, therefore, are not so personal as they would be if an official could walk two or three rooms across and speak to the finance-cum-accounting officer to expedite his case. The nearness of the finance-cum-accounts officer, both physically as well as mentally, to the executive officer, would also inculcate in the latter a better sense of finance and accounting—the lack of which is partly responsible for delays. During World War II, the system of attached financial advisers was in existence in the Central Supply Department and it is my personal experience, as well as perhaps the experience of others, that this Department, to which financial advisers were attached was more finance-minded than others.

(d) The Accountant General's office now is generally a very big one. The number of people working in such an office varies from 1,000 to 2,000. As development expenditure goes up, as it should, the staff of each Accountant General will also multiply by leaps and bounds. A point would be reached when every office would become unwieldy. It would be easier, also, for things to be lost in bigger offices and there would be greater scope for misunderstanding between audit and the executive.

From the administrative point of view, there is no doubt that accounts should be closely interlinked with administration. At present, there is a great deal of diffusion of different functions. Even in accounting matters, the Accountant General does not compile accounts right from the bottom. The initial accounts are compiled by authorities outside his control. The present Auditor General, Mr. Ashok Chanda, has expressed himself quite strongly in favour of separation and has stated that "the malaise of our administration has been this unnatural divorce of authority from responsibility. It felt that the transfer of accounting responsibilities to the Ministries should, therefore, be the first step towards the evolution of an acceptable and logical pattern of administration. It would provide the Ministries with the means of controlling the appropriations in accordance with the votes of the Parliament, and introduce a greater flexibility in the utilisation of available resources by the process of permissible reappropriations, and lastly, it would enable them

to keep a close watch on the progress of their plans and programmes".²

Arguments against Separation

(a) The first argument against separation is that it would be costlier. This is easily understood. At present accounts compilation and audit are combined and there are certain economies, what may be called "overhead charges" in private firms. The question of man power is also pertinent. The official "An Introduction to Indian Government Accounts and Audit" puts the problem as follows:—

'In 1924 an experimental scheme of separation of Accounts from Audit was introduced on the civil side in the United Provinces (now Uttar Pradesh) and also in certain departments of the Government of India. This experiment was abandoned in 1931 expressly on financial grounds, as the separated Accounts system was found to be more expensive. The system of Combined Accounts and Audit, is however, unsound in theory, and it tends to undermine the independence of audit by combining with it the functions of accounts, which are entirely those of the executive authorities. Manpower problems now stand in the way of this very necessary reform which will have to be seriously taken up when the manpower position improves".³

(b) Since accounts and audit are combined at present, this gives auditors a chance of knowing where to seek for irregularities and weaknesses. As a matter of fact, the bulk of the audit is done when vouchers are checked up with orders, etc. before being incorporated in the accounts. If at that stage major weaknesses are detected, then inspection staff visit the places concerned and try to get as complete a picture as possible of irregularities and defects. If accounting is separated from audit then audit authorities would not have this close knowledge. They would be forced to rely

² Speech by Mr. Ashok Chanda, inaugurating the Class II Officers' Association of the Indian Audit and Accounts Department, on 4th February 1956, p. 3.

³ An Introduction to the Government Accounts and Audit, p. 53.

on what the accounts authorities tell them. This may not work. It would be against human nature to tell auditors and other fault-finders where one has committed mistakes. And accounts authorities working in close co-operation with the executive and separated from audit are more likely to side with the executive than with audit in such matters. Added to this is the special Indian feature of caste. In spite of the best efforts of great sons of India for centuries, casteism of various forms, and in different fields, had not been rooted out from India. It is much stronger than the class spirit in other countries, and it takes ever new forms. Thus, any one who has worked in an Indian administration knows that its chief weakness is that it is wrought through and through with caste feeling. If the auditor is regarded as belonging to a separate species, he would be subjected to caste feeling in the most virulent form and would also be a social outcaste. He will try to take revenge by harping on every item of difference even if such differences are petty. And so the vicious circle would go on.

(c) At present audit and accounts matters are supervised by the Indian Audit and Accounts Service. The members of this Service are recruited by open general competition. They are, therefore, men of high intellectual calibre. Several people who have distinguished themselves in other walks of life have come from this Service. For instance, Sir C.V. Raman, the great physicist, Mr. Ghulam Muhammad, former Governor-General of Pakistan, and Chaudhury Muhammad Ali, former Prime Minister of Pakistan. This indicates that the men who man this Service cannot be regarded as despicable "spivs" whose main occupation is to pour over figures and to find fault with others. This Service, which is responsible so much for good financial administration in India, will have to be destroyed if accounts is separated from audit.

(d) We are having a lot of changes in India. We should, therefore, go slow. Otherwise, "confusion would be worse confounded" and in no sphere of government is there chance of greater confusion than in accounts.

A Consideration of the Case. It will thus be seen that there are arguments on both sides. The arguments in favour of

separation seem to be unanswerable. This has been admitted in the official "An Introduction to Indian Government Accounts and Audit" (*vide* reference quoted above). The former Auditor General, Mr. Narahari Rao, as well as the present Auditor General, Mr. Ashok Chanda, have spoken in favour of separation. On the other hand, the arguments against separation also have force. Separation would undoubtedly be costlier. Also, much of the cost would have to be borne by the States. At present, by an anomalous arrangement which has its origin in past history, the cost of keeping accounts for the States is borne by the Centre. The State scales of pay are lower than those of the Centre. Hence, there may not be much ultimate increase in the total cost of accounts and audit, even if accounts are decentralised *vis-a-vis* the States and departmentalised as regards the Centre. In any case, decentralisation will very probably come, sooner or later, for another reason. Under Article 345 of the Indian Constitution, a State can determine what language it will use for official purposes. Some States have already passed legislation under this article, and others will probably do so in the near future. Correspondence in accounts and audit matters has to follow the language adopted by the State. Once this happens, even in one State, the process of decentralisation would have to start. This eventuality would meet the argument against the dismemberment of a Service in which its members take pride.

So far as the lack of contact with affairs and cold-shouldering by the executive goes, it has to be remembered that a separate system is in operation in the Defence Services and in the Railways. If this has worked there so long, there is no reason why the system should not work on the Civil side. It is true that "casteism" in the services, which even the Prime Minister had to refer to some time back in a public speech, is rampant in the Indian administration, and strong caste feelings against auditors in the civil side would make their work more difficult, vexatious and humiliating. The problem here is a general one, namely, how to mitigate casteism. Many officers of the I.C.S. and other Services in the Centre and elsewhere are already applying their minds to this problem. To the extent that finance, accounts and

audit are concerned, this aspect is discussed in Chapter 12 below.

The doctrine of "confusion worse founded" is a very general one and can be applied in resisting any change. This doctrine by itself cannot have much meaning and is really meant to safeguard bureaucratic inertia and laziness. If changes are thought to be good on other grounds, there is no reason why bureaucrats, if they are worth their salt, should not so work as to avoid confusion. However, this is a general question and it is dealt with, in a general manner, in the last chapter of this book.

On a balance of considerations it seems to the present writer that the arguments lie in favour of separation, especially as decentralisation is bound to come sooner or later with the adoption of regional languages by different States, over and above the reasons already given in favour of separation. In foreign countries like the United Kingdom, U.S.A., U.S.S.R., etc. there is no combination of accounts and audit. In India also a separated system is in existence, apart from the Railways and the Defence Services, in projects like Hirakud, Kosi, D.V.C., etc. The system is working there. One may ask that if the former Auditor General and the present Auditor General are in favour of separation why has it not been carried out? The answer, of course, obviously is that very many persons and authorities are concerned. There is also the question of cost, much of which will have to borne by the State Governments, whereas they are not bearing anything just now. And there is the question of personnel.

Conclusions. It will, therefore, be seen that the problem of separation of accounts from audit is wider than a purely bureaucratic one. As Mr. Chanda has said, in the quotation given earlier, separation would provide Ministries with the means of controlling the appropriations in accordance with the votes of the Parliament, introduce greater flexibility in the utilisation of available resources, and enable administrative authorities to keep close watch on the progress of their plans and programmes. Ethically also, there is no reason why the head of an administrative department should not be responsible for what his subordinates do. For instance, if his

subordinates misuse their position and draw travelling allowance irregularly, it should really not be the function of an outside authority to find this out and to castigate them. The head of the departments should do this and perhaps take more drastic measures than is being done now. This is the position in a good firm. In a good firm, finance, accounts and internal audit are combined. If this feature is adopted, there should be financial advisers-cum-accounts officers in the governmental pattern in each big department, groups of small departments and projects. External audit, which is necessary, as we saw in Chapter 8 above, for purposes of democratic control, may then be resident concurrent audit, as is mainly the position in the United Kingdom. The main function of the resident auditors would be to examine the appropriateness of contracts, agreements, etc. leaving watch over irregularities as regards drawal of pay, travelling allowances, etc. to financial advisers-cum-accounts officers. The resident auditors would necessarily have to be in close touch with their opposite numbers dealing in finance as matters well as with the executive. The real problem then would be to get really good resident auditors, who would be respected, and whose words would not be dismissed as coming from impractical and absurd people. This problem of personnel is discussed further in Chapter 12 below.

AUDIT OF PUBLIC CORPORATIONS

Problem. We now have many public concerns and their numbers are increasing. What agency should audit their accounts? Should it be the Auditor General, or private auditors? This question has agitated legislators, administrators and people interested in such matters for some time. Matters came to some sort of a head in May 1956 in connection with the audit of the Life Insurance Corporation. Ultimately, in that case, it was decided that audit should be left to private firms. But the general question remains open. The views of the ubiquitous Dr. Appleby have not been officially released, but it is well known that he has been strongly opposed to the audit of public concerns by the Comptroller and Auditor General of India. The late Finance Minister of India, Sir Chintaman Deshmukh, was also vehemently opposed to the audit of public concerns being carried out by the Auditor General. Both Dr. Appleby and Sir Chintaman Deshmukh were concerned about the "mechanicalness" of government auditors. Sir Chintaman also thought that in institutions where a large measure of discretion has to be left to higher executives, the system of government audit is not suitable. He stated in Parliament:—

"Where important commercial considerations are involved, like the State Bank or the Insurance Corporations, since government officers lack experience of the work in such enterprises, Government would not like the success of these recently nationalised ventures to be jeopardised by some violent change in the system. Such institutions cannot be run without the exercise of a large measure of discretion by higher executives, and any system which makes it possible for audit to raise objections to the exercise of such discretion is bound to paralyse their working. Undertakings like the Insurance Corporation are basically different from Government's ordinary business and, until we have had some experience of their

working, it seems to us to be best to maintain the status quo".¹

What is the position in other countries? The experience of other countries might be helpful to us.

The United Kingdom. In the United Kingdom this matter has been considered in detail, especially after the creation of the great public corporations after 1945. Even before that year, the matter assumed serious form during the very thick of World War II. The B.B.C. received grants for its overseas service and for monitoring activities, which were not provided for in its Charter. The question arose as to whether, and if so how far, the spending of government money was a concern of the Public Accounts Committee. The activities of the United Kingdom Commercial Corporation were on a somewhat similar footing. This was a State-sponsored concern operating chiefly in the Middle East. Its activities were government-approved and often strategic rather than commercial. In both the cases the Public Accounts Committee decided that the Comptroller and Auditor General ought to have powers of scrutiny. In their Report (1942-43), they observed:—

"It appeared.....inadmissible that expenditure of the nature and magnitude now being incurred, wholly financed from public funds, should be entirely exempt from control".²

In the case of the great post-1945 public corporations of the U.K., the Acts creating them give the Comptroller and Auditor General no right of access to their books and laid upon him no duty to report on their accounts.³ This, however, does not in any way diminish the right of the Public Accounts Committee to look into the accounts of the corporations. The matter was debated in detail during the passage of the Coal Industry Nationalisation Bill. Amendments were proposed, both in committee and on the report stage, to empower the Comptroller and Auditor General to examine the accounts of the corporation and to require him to certify them. The Labour Government

¹ *The Eastern Economist*, Vol. XXXI, No. 22, June 1, 1956, p. 843.

² Quoted in Basil Chubb, *The Control of Public Expenditure*, (Oxford 1952), p. 144.

³ Basil Chubb, *Op. Cit.*, p. 145.

rejected the amendments on the grounds that there would be danger of interference in the day-to-day affairs of the corporations, and that in any case, the Public Accounts Committee could always send for persons, papers and records.⁴ Mr. Chubb, an expert in these matters, thinks that "in view of the actual way in which the Committee works and of its dependence on the Auditor General, this latter reason was unsound".⁵ In discussions in 1948 and 1949, the members of the Public Accounts Committee could not do much as regards the accounts of public corporations. They did not have preliminary reports from the Comptroller and Auditor General, nor his day-to-day assistance. Under the circumstances, their examination was general and superficial, and discussions were fruitless.⁶ The problems were left unsolved. Special Select Committees have been suggested to look into the affairs of public corporations, but the matter is still fluid.⁷

Canada. In Canada there are many public corporations, known as Crown Companies. I studied the activities of some of these Crown Companies in Canada in 1952, but the question as to who did the auditing was at that time of no particular concern to me. Hence, this aspect was looked into only incidentally. The position is that in some of the Acts constituting the different Crown Companies it has been specifically laid down that the Auditor General of Canada would audit the accounts. For instance, the Canadian Broadcasting Corporation, the Export Credits Insurance Corporation, the St. Lawrence Seaway Authority, the Canadian Maritime Commission, etc. In some other cases, the relevant Act lays down that the Minister concerned would appoint the auditors with the approval of the Governor General in Council. For instance, the Central Mortgage and Housing Corporation, the Trans-Canadian Airlines Corporation and so on. I was told that in some cases where the discretion to appoint auditors was vested in the Minister

⁴ Basil Chubb, *Op. Cit.*, pp. 145-146.

⁵ Basil Chubb, *Op. Cit.*, p. 146.

⁶ Basil Chubb, *Op. Cit.*, p. 147.

⁷ Basil Chubb, *Op. Cit.*, pp. 257-259.

and the Governor General in Council, the tendency was to appoint the Auditor General.⁸

U.S.A. In the U.S.A., government participation in economic activities is negligible. Hence, the question of the audit of such concerns does not arise. Also, as we have seen, the various Congressional Committees in the U.S.A., so far as the Federal Government is concerned, are aggressive, and look into estimates of expenditure in great detail before sanctioning them. Funds do not always lapse at the end of the year, and so it is possible to fix appropriations, year by year, in detail. The Comptroller General has also the power to disallow illegal expenditure. Under the circumstances, audit on the British pattern is neither necessary nor possible in the U.S.A..⁹ It is but human that even the greatest of experts would be influenced, in their recommendations of how things should be run in a foreign country, by conditions at home, especially if the home country is the first country in the world. Dr. Appleby's point of view as regards the utility of audit can really be understood only with reference to American conditions. Possibly if the whole American system were imported to India, it might be better than the present system and the present type of audit may not be necessary. But is there any thought of importing any feature of the American system, leave alone the whole of it, as regards public legislation and administration? One logically cannot, in the same breath, say that we should not have the restraints which exist in America, but only the liberties of that country.

U.S.S.R. A detailed description of what goes on in the U.S.S.R. is quite unnecessary in view of what has been stated in Chapter 8 above regarding "khozaschyot" activities. Any one who has even the slightest acquaintance with Soviet periodicals and journals is aware of the extent to which the "khozaschyot" concept dominates Soviet public thinking. This has even invaded the sphere of literature, to the dismay, no doubt, of non-Soviet readers. This economic accounting

⁸ O. K. Ghosh, *The Role of the Canadian and U. S. Governments in the Promotion and Execution of Economic Development Schemes* (Government of India 1953), p. 17 *et seq.*

⁹ Samuel H. Beer, *Treasury Control*, (Oxford 1956), p. 48.

and scientific evaluation is a feature which, it seems to the present writer, can well be adopted in India, as our country is far from being so capital-rich as the U.S.A.

An Analysis of the Case. The first question is whether Parliament should have any control over the financial activities of public corporations or not. The words of a distinguished non-partisan man of public affairs may merit attention here. Sardar K. M. Panikkar has given his opinion in the matter as follows:—

“So long as the funds involved belong to the government, the responsibility to Parliament cannot be overlooked or ignored on the ground that they are being managed on a commercial pattern. As long as the Minister in charge is ultimately responsible to Parliament for the investment, his responsibility cannot be shirked and this would mean an overall supervision and control by the central administrative machinery. By merely constituting these operating units into companies and thereby bringing them under the operation of the Company Law, it is obvious that the authority of Parliament cannot be ousted so long as the company is run by government officials and the investment is wholly that of the government. Any attempt to do so would be nothing less than a fraud on the Constitution. To expend vast sums of public money without the normal control to safeguard public interests would naturally be resisted by Parliament which is the guardian of public funds. Whether departmentally administered or by companies or corporations so long as the funds are provided by the authority of Parliament, Parliament’s jurisdiction cannot be ousted”.¹⁰

The above view seems to be the only one possible to hold. The question then arises, which is the best agency, so far as audit goes? A governmental agency or a private agency? Sir Chintaman Deshmukh, the former Finance Minister of India, thought that governmental audit would

¹⁰ *The Eastern Economist*, Vol. XXVI, No. 18, February 17, 1956, p. 252.

hamper the activities of public corporations, where commercial considerations are involved. Sir Chintaman was perhaps influenced by the debates which had taken place in the British Parliament about a decade ago. British circumstances and Indian circumstances are quite different. In the U.K. the Labour Government took over "going concerns". The men in these "going concerns" knew their jobs thoroughly well and there had been the long tradition of audit by private companies of the concerns taken over. The position in India is entirely different. In most public corporations, if not in the Life Insurance Corporation, governments have to start activities from scratch. Hence the considerations in the quotation from Sir Chintaman's speech given earlier in this chapter cannot apply to government commercial undertakings in general. The "Eastern Economist" has rightly pointed out that Sir Chintaman's views can be considered to be correct only on the assumption that private commercial methods are better than public methods in the business field.¹¹ This is a dangerous assumption and cuts at the very root of the idea of a socialistic pattern of society, where production is, to a great or less extent, socialised. If private business methods are better than governmental methods, then a layman would ask, and perhaps with justification, why should government enter into business at all? If it is held that governments should enter into some spheres of business, then obviously the legislature should have control, through its own instruments, on such business activities. The Comptroller and Auditor General is an instrument of Parliament. As we have seen above, the U.K. experience is that the Public Accounts Committee can function well only with the assistance of the Comptroller and Auditor General. It seems, therefore, that the balance of arguments in an underdeveloped country like India is in favour of the Comptroller and Auditor General. This seems to be the view of some businessmen and administrators also. For instance, Mr. Tulsidas Kilachand, M.P., the well-known businessman, says:—

"Also, State enterprises shun public control
and public accountability on the pretext of autonomy."

¹¹ *The Eastern Economist*, Vol. XXVI, No. 22, June, 1, 1956, p. 844.

"This may be illustrated by the recent controversy about exempting State enterprises from parliamentary control, the Auditor General's scrutiny, the application of the provisions of the Companies Act and other regulatory enactments".¹²

In the U.K., the officers of nationalised industries know their jobs well. It would be of interest to know what a business man thinks of their counterparts in India. Mr. Tulsidas Kilachand says:—

"What is to be guarded against is the presumption of omniscience and omnipotence so common in a tyro. Undaunted by the realities of experience, he is inclined to think that somehow he is better fitted to do a particular job than even those with proved merit".¹³

Mr. A. D. Gorwala¹⁴ and Mr. R. N. Banerjee, the former Chairman of the Union Public Service Commission,¹⁵ are both against the kind of extreme independence for the public corporation executive which some people seem to recommend.

If the Comptroller and Auditor General's men are "mechanical" in their outlook, what guarantee is there that private auditors are likely to be very much better? In any case, the remedy against "mechanicalness" would seem to lie in taking steps to do away with all "mechanicalness" and not in doing away with the instrument of Parliament in scrutinising the financial activities of public concerns.

Two important sociological considerations also would have to be remembered. In the United Kingdom, the nationalisation measures were initiated by a Labour Government. It is possible that there was some subconscious, if not conscious feeling, that in the Public Accounts Committee, led by a member of the Opposition, Conservative and not Labour views might prevail. It is possible that it was feared that their interference in the activities in the public corporations might throw doubt on the very question

¹² Supplement to *Capital* of December 20, 1956, p. 33.

¹³ Supplement to *Capital* of December 20, 1956, p. 33.

¹⁴ *Statesman* (Dak Edition) Wednesday, November 25, 1956.

¹⁵ *Statesman* (Dak Edition) August 31, 1956.

of the principle of nationalisation, which was then so dear and holy to the Labour Party. On the Indian side also, there is a sociological consideration. In spite of all efforts to do away with casteism in different fields, it still persists. Of course, it is now very much more camouflaged than it used to be. So detached an observer as Professor M. S. Srinivas, the distinguished anthropologist, stated at the January 1956 session of the Indian Science Congress that casteism operates in many forms in India. Is there any guarantee that autonomous public corporations, left with complete freedom in all matters, and without the normal and natural checks which apply in private firms, would not succumb to the enormous pressure of caste and family considerations in spending public moneys, wherever this may be possible? The well-known adage, "set a thief to catch a thief," applied to this sphere, would point to the use of government auditors to scrutinise the activities of autonomous public corporations rather than of private auditors unversed in the mysterious ways of government officials. Public corporations should have as much freedom as possible, but this would seem to lie more in the direction of freedom from excessive Secretariat interference rather than *effective* legislative control. The U.S.S.R has not done badly at all so far as their industrial activities go, in spite of the manifold checks which "khozraschyot" implies. Perhaps we could do with much more "khozraschyot"?

Conclusion. It seems that the legislature would be able to control the financial activities of public corporations best through its instrument, the Comptroller and Auditor General of India. If his audit is "mechanical", then the proper solution would seem to lie in taking steps to do away with this "mechanicalness" and not in bypassing the instrument. "Khozraschyot", and more and more of it, rather than complete freedom for the executives of public corporations to do what they like, seems to be the best way for a Development State to prosper. That is the way how things are being done in Development States like the U.S.S.R. And, in countries like the U.S.A., the executives of private firms have to show bigger and bigger results or they stand the risk of being "fired" on the spot. Security of tenure surely goes

ill with the spending of the tax-payers' money but no effective control by the tax-payers' representatives? The objection regarding the imperfection of the tax-payers' instrument in the sense of its being "mechanical" is another matter. The problem of how to mitigate such "mechanicalness" is dealt with in Chapter 12.

CHAPTER II

THE PUBLIC ACCOUNTS COMMITTEE AND THE DEVELOPMENT STATE

Problem. In India, as in the United Kingdom, the Legislature has a committee known as the Public Accounts Committee. The Parliament has a Public Accounts Committee; each State Legislature has a Public Accounts Committee. These Public Accounts Committees scrutinise the Appropriation Accounts and the Audit Reports prepared by the Accountants General who are subordinate to the Auditor General. These Committees consist of varying numbers of members elected by the Legislature. The Chairman is usually, but not always, a member of the opposition. In most places, the Finance Departments function as their Secretariat and they are assisted in their deliberations by the Accountant General also. The main problem is, is there any difference between a Public Accounts Committee in a Law and Order State and in a Development State? If so, how can the Public Accounts Committee work best in a Development State so that it can make contributions to policy and the running of the State?

Analysis. In the British colonial regime audit was concerned mainly with exposing breaches of regulations. This was partly on the contemporary British pattern. Partly, however, this arose because the Executive was *not* responsible to the Legislature for many subjects. Hence, there was little question of criticising the action of the Executive. Breaches of regulations committed by officers constituted the main topic in Audit Reports. However, as audit criticised the activities of government, which was the British Government, there may have been a certain amount of public feeling in favour of audit. The situation has now changed. Critics are nowhere loved and in a Development State it is always possible for those who are criticised to say: "after all, in spite of everything such and such has been done". The essence of audit in a Development State would, therefore, have to be to assess at what cost per rupee "such and such has been done"

and compare the achievement with achievements elsewhere in the country, in the public sector and, if possible, in the private sector. In other words, the main purpose of audit would be to take part in what the Prime Minister has called "scientific evaluation". In the U.S.S.R. this word bears the name "khozraschyot". Strictly speaking, "khozraschyot" means "economic accounting", but it has really the same connotation as the word "scientific evaluation" used by the Prime Minister. "Khozraschyot" activities have not been developed to any great extent as yet in this country. The Planning Commission have now set up certain evaluation committees. But from what has been stated in Chapter 8 above, it will be seen that in the U.S.S.R. "khozraschyot" is very extensive and systematic. Unfortunately, there is very little literature about "khozraschyot" activities, which have apparently to be seen in detail, in order to judge their applicability to Indian conditions. The ideal would seem to be to have "khozraschyot" teams in which there would be representatives of administrative departments, the Development Commissioner's office, audit, and economists and statisticians. The main function of audit in the "khozraschyot" teams would be to see that there has been adequate financial stock-taking of development schemes. For each scheme there are physical targets and financial targets of expenditure. And the task of audit would be to see that there is proper check, and certificates of physical achievement, by competent officers, and that financial stock-taking has been done. It would then check the financial stock-taking processes and certify their correctness. It would also examine contracts, agreements, etc. from the propriety and economy points of view. In the existing "Audit Code" there is already provision for financial stock-taking and the present Comptroller and Auditor General has been constantly stressing this aspect. But in the governmental apparatus such ideas have to be accepted all round, and pressed by the public, before they can be institutionalised. There are obvious reasons why many executive officers would not be interested, to begin with, in stock-taking. The more efficient ones might think that this is a slur on them. Others, who are less efficient, might think that their faults would be found out if there is scientific

evaluation, or “khozraschyot”. In a recent inter-regional conference pertaining to community development (held in the end of 1956,) a very senior State Government official, who presided, thought aloud on this issue of scientific evaluation, when it was posed. He admitted the necessity for scientific evaluation, but asked, in view of the limited number of personnel available, what proportion of it could spend their time in evaluation. It seems to the present writer that there is no scope for doubt in this matter. In a private firm there would be no question of executive officers doing things without any check as to what precisely is being done and at what cost per rupee. In Development States like India and the U.S.S.R such scrutiny, to see that work is being done according to programme, and that the outturn per unit of money or per man is the best possible, devolves upon the State. Reference has been made earlier to Molotov’s remark that without checking on fulfilment, plans will remain on paper, and in one’s imagination.

To make matters a little clearer as to what is meant by stock-taking, a simple *pro-forma* is given below, purely by way of illustrations:—

1. Serial Number.
2. Name of the Schemes.
3. Date begun.
4. Date of Completion.
5. Whether the scheme is classed as productive or unproductive.

¹ Rovinskii, *Finansovaya System a SSSR* (Moscow, 1952), p. 144.

ALLOTMENT AND PROGRESS OF EXPENDITURE

- | | | |
|----|---|--------------|
| 6. | Total estimated five year cost. | |
| | Estimates at the beginning of the year first year. | |
| | Actuals at the close of the year. | |
| | Estimates at the beginning of the year second year. | |
| | Actuals at the close of the year. | |
| | Cumulative actuals to the end of second year. | |
| | Estimates at the beginning of the year. | Third year. |
| | Actuals at the close of the year. | |
| | Cumulative actuals of the end of the year. | |
| | Estimates at the beginning of the year. | |
| | Actuals at the close of the year. | Fourth year. |
| | Cumulative actuals to the end of the fourth year. | |
| | Estimates at the beginning of the year. | Fifth year. |
| | Actuals at the close of the year. | |
| | Cumulative actuals at the end of fifth year. | |
| 7. | Incidental expenditure on planning and preparation. | |
| 8. | Total expenditure till completion. | |

PROGRESS OF WORK TARGETS ACHIEVED

9. Annual recurring maintenance cost after completion.
10. Planned target (Physical)
 - First year.
 - Second year.
11.
 - Third year.
 - Fourth year
 - Fifth year
12. Material deviations from sanction schemes together with reasons thereof.
13. Losses incurred with details.
14. Benefits devolved, e.g. additional revenue accrued, etc.
15. Remarks.

The above rough *pro forma* can, of course, be refined in very many ways.

Another basic task of audit in Development States would be to comment on the appropriations by broad sub-heads.

Appropriation Accounts have to be prepared under the Constitution (Article 151). The Appropriation Accounts are at present bulky documents. If the reforms suggested in Chapter 3 are carried out, the Appropriation Accounts would be smaller, and the heads more susceptible to intelligent criticism by laymen, as these heads would be functional heads. For instance, let us consider the following sub-heads under, say, "roads":—

31 Roads

- o administrative staff.
- 1 training of personnel.
- 2 research and statistics.
- 30 national highways—new
- 35 national highways—improvement.
- 40 inter-state and other roads—new.
- 45 inter-state and other roads—improvement.
- 50 state highways—new.
- 55 state highways—improvement.
- 60 district roads—new.
- 65 district roads—improvement.
- 70 municipal roads—new.
- 75 municipal roads—improvement.
- 80 village roads—new.
- 85 village roads—improvements.
- 90 bridges—major.
- 91 bridges and culverts—minor
- 95 miscellaneous.

Each of the above sub-heads is an intelligible unit, and expenditure by these sub-heads can be criticised very usefully by members of Public Accounts Committees. The details within these units might be left to executive officers, unless there are *prima facie* suspicions or evidence that things are going wrong. From what has appeared in various papers it appears that Dr. Appleby prefers shorter and more selective reports for legislatures and their committees. If budgetary classification is altered, as suggested in Chapter 3 above, then the budget as well as the appropriation accounts, which seek to bring out how the budget has been followed in practice, would both be much shorter, and intelligible to non-specialists.

The adoption of the above suggestions might make desirable reorientation in the presentation of the audit reports as follows:—

- Part I. General remarks on the Appropriation Accounts and on budgetary methods and techniques.
- Part II. Comments on the appropriation accounts, the unit for comment purposes being the sub-head under each head (on the assumption that budgetary and accounts classification would be as suggested in chapter 3 above).
- Part III. Financial irregularities, losses, etc.
- Part IV. Report on loans and grants from the Centre.
- Part V. List of officers not submitting vouchers, estimates, etc. together with amounts outstanding year by year, arranged under Controlling Officers, and under each Controlling officer by Drawing Officers.
- Part VI. Financial stock-taking of development schemes.
- Part VII. Report on the audit of public concerns.
- Part VIII. Debt position.

Each of the above Parts can be printed separately, if desired, so that they may be considered in detail by Sub-committees of the Public Accounts Committee. The really important parts would be Parts I, II, IV, VI and VII. Not much by way of practical purpose would be served in the reorientation of the presentation of Audit Reports, in the manner suggested above, unless “Khozraschyot” activities become much more widespread, and there are changes in budgetary classification as suggested in Chapter 3. Such activities, and consequential changes in the presentation of the Audit Reports, would strengthen control by the Public Accounts Committees and so by the legislature.

There are a few subsidiary questions pertaining to the method of work of the Public Accounts Committee which are of importance, *viz.*:—

- (a) the chairmanship of the Public Accounts Committee.
- (b) its secretariat; and
- (c) its splitting up into sub-committees to consider different aspects of work.

The convention in the U.K. is that the Chairman of the Public Accounts Committee is a distinguished Member of the Opposition. The Public Accounts Committee obviously functions well only where there is a good Opposition Party. Otherwise, it is but natural that it would be somewhat weak. Nevertheless, even if such an Opposition Party is lacking, it would be starting a good tradition to have as Chairman of the Public Accounts Committee a Member of the Legislature not belonging to the ruling party. In some States in India, the Chairman of the Public Accounts Committee is the Finance Minister himself. The Chairman of the Public Accounts Committee is supposed to be a fair and just critic of government. Is it not too much to expect that a man in public life, who is in government, would be able to criticise his own actions and those of his colleagues in a just manner. Should there not be an all-India convention in this matter?

The question of the secretariat of the Public Accounts Committee is equally important. The general Indian practice in the past has been to thrust the duty on the Finance Departments as an additional duty. In the Indian Parliament this procedure has been changed. There is a separate Secretariat for dealing with Public Accounts Committee matters. And, this Secretariat forms part of the Parliament (Lok Sabha) Secretariat. The same objections which apply, in principle, to the Finance Minister being the Chairman of the Public Accounts Committee, apply to the Finance Department being the Secretariat of the Public Accounts Committee. If the Audit Report is to be effective, there should obviously be whole-time pursuit and follow-up action of the suggestions made by the Members of the Public Accounts Committee. Otherwise, it is possible that in the tremendous rush of paper work these suggestions would be lost sight of and democratic control would be superficial, and perhaps to a large extent formal. If the various legislatures do not have their separate secretariats for the purpose, the Accountant General's Office should be, in logic, a fitter place than the Finance Department as the secretariat of the Public Accounts Committee.

The Sub-Committee system might be a good one to follow where work is complicated and varied. This procedure is already being followed in some places.

In the United Kingdom, the Public Accounts Committee and its Sub-Committees deliberate on a year's accounts and the audit reports thereon for over 100 hours per year. In most Indian States, Public Accounts Committee meetings are for about 15-20 hours for each year. The amount of interest in a work is not necessarily proportionate to the time spent on it, but generally speaking this is true. Perhaps the facts that "khozraschyot" activities are at a rudimentary state and the logic behind the budgetary classification, and, consequently, the appropriation accounts, difficult to follow, have some thing to do with the shorter hours spent in India on the appropriation accounts and the audit reports. Also in the United Kingdom, there is a long tradition of close financial control by Parliament. Democracy began in that way there. In India, there has been no such comparable tradition. In the Development State, "bulk audit" rather than detailed audit would be, in the fitness of things, more the concern of legislatures. Breaches of regulations can be left more to internal departmental audit if the financial adviser-cum-chief accounts officer system is introduced. External audit might concern itself more with "khozraschyot" or scientific evaluation activities.

Conclusion. The necessity of scientific evaluation has been stressed by the Prime Minister. In a Development State, like the U.S.S.R., such scientific evaluation or "khozraschyot" is inextricably linked with planning. "Khozraschyot" activities have just begun here and it might be advisable to see how things are done in other Development States like the U.S.S.R., China, etc. in this field of technique; something useful may be learnt. In a Development State if there are "khozraschyot" teams audit can play a useful part in such teams. Its specific task would be to see that there is adequate financial stock-taking of development schemes, and this aspect can be reported separately and generally in the Audit Report, apart from the detailed reports of the "khozraschyot" teams. The mechanics of this can be worked out without much difficulty if the general principle is accepted. If the budgetary classification is made more "functional" than at present then both the budget and the appropriation account would become simpler and more intelligible docu-

ments. It might then be possible to reorient the appropriation accounts and the audit reports so that comments on the "functional" appropriation accounts and "khozraschoyt" activities figure in a prominent manner. All these proposed changes would serve to strengthen democratic control immensely by making the hold of the Public Accounts Committees over affairs much stronger. The question of the Chairmanship of the Public Accounts Committee, its secretariat and its breaking up into sub-committees to consider various aspects of matters are also very important. Without a whole-time impartial Chairman, and secretariat, unconnected with departmental activities, full democratic control may not be possible, and suggestions made by the Public Accounts Committee and their Sub-Committees may be lost sight of.

CHAPTER 12

PERSONNEL FOR, FINANCE, ACCOUNTS AND AUDIT WORK.

Problem. This chapter is based on the assumption that the changes suggested in chapters 6 to 10 above would be acceptable. This is to say, that there would be separation of accounts from audit, a consequential financial adviser-cum-chief accounts officer system, and resident auditors under the State auditors. The problems then would be to ensure the independence of financial advisers-cum-chief accounts officers and resident auditors, as well as to provide men for these posts with a sufficient knowledge of administration. How best can be twin aims be realised?

Suggestions. In the United Kingdom and in the U.S.A. the basic principle is that personnel at higher levels are moved about as much as possible. In fact, there is even a tendency to interchange men in administration with those in the world of learning.¹ In the U.S.A. this tendency is fairly well marked. The precise position in the U.S.S.R. is not known, but there is some circumstantial evidence that at the higher levels there is a great deal of movement between different departments. On principle, such movements seem to be good. Thereby, the staleness in the outlook of men is mitigated, thus leading to fresh and vigorous minds being applied to different sides of government work. The logical conclusion, if this principle is followed, is that close and water-tight Services should be eschewed as far as possible. A Pool of officers is always better than a Service, wherever the other conditions make it possible for a Pool to be formed. In India, there is another reason why Pools should be preferred to Services, wherever this is possible. India is a land of casteism, which all the efforts of her best sons and daughters have not been able to eradicate completely. Services in India, each with its defined sphere of operations, become castes, and the sense of the unity of administration is blurred in a

¹ Wyn Griffith, *The British Civil Service, 1854-1954*, (Her Majesty's Stationery Office, London 1954), pp. 22-23.

Services-ridden government. Often, even social mixing between different castes and sub-castes in government becomes difficult. Employees in the lower ranks of government are so imbued with the caste idea that it is difficult to prevent them from adding different letters like I.C.S., I.A.S., I.A. & A.S., B.C.S., etc. after the names of officers. There are Services with prouder traditions than those of India in other countries in the world, but nowhere is the fantastic practice of adding such letters to one's name followed.

Finance and audit are essentially part of administration. A good finance man and a good audit man have to know administration "from inside". Accounts is an adjunct of administration, and should be as simplified as possible, especially in a country like India, where the functions of administration are fast enveloping neo-literates, whose standards of education are by no means high. A highly subtle, refined and complicated system of accounting would only confuse these neo-literates. Finance and audit men should know administration, in its widest sense. That is to say, not only district administration and general administration, but also, as far as possible, the working of bigger departments like public works departments, social services departments, etc. In other words, the net for the formation of the Finance, Audit and Accounts Pool should not be restricted only to officers in general administration, but should extend to people in the engineering services, the various social services, etc., who have a knack for finance.

Accounts and audit are under the Comptroller and Auditor General of India. The financial advisers-cum-chief accounts officers and the various resident auditors will, therefore, have to be subordinate to him. In logic, therefore, the Finance Accounts and Audit Pool should be under his control. At any rate, he should have a very great say in the formation of such a Pool and the posting of its officers, as such a Pool would have to take the place of the Indian Audit and Accounts Service. If the financial adviser-cum-chief accounts officer is an officer of the Comptroller and Auditor General, though for the time being under the administrative control of the department to which he has been seconded, he would have greater independence than if he belongs to

the department in question or even to the government concerned.

If the above basic postulates and their logical implications are followed, then the picture of the system which would emerge would be something as given below. There would be a Pool of officers consisting of men from the administrative services like the Indian Civil Service and the Indian Administrative Service and various Revenue and Accounts Services like the Indian Audit and Accounts Service, as well as some men from the technical services, especially from the Public Works Departments. Roughly speaking, there are three stages in the hierarchy of officers, according to the Indian practice, corresponding to Assistant Accountant General, Deputy Accountant General, and Accountant General or Under Secretary, Deputy Secretary and Secretary. An intermediate grade between Accountant General and Deputy Accountant General and between Secretary and Deputy Secretary has been arising for some time. Hence, officers will have to be provided for all of these grades. After about ten years or so in a Service people may be selected for the Finance, Accounts and Audit Pool. They might get their own grade pay in the parent Services *plus* a special pay, over and above their grade pay, to make entry into the Pool attractive. The pay of the Financial Advisers-cum-Chief Accounts Officers and State Auditors would have to be fixed in a different way. That is to say, there would have to be recognised grades of pay for these posts, which would be applicable to all incumbents regardless of the Service of origin. Once in the Pool, an officer need not be there for the rest of his career. There would be a tenure system. For instance, say three years in the rank corresponding to Assistant Accountant General/Under Secretary, four years in the rank corresponding to Deputy Accountant General/Deputy Secretary and five years in the rank of corresponding to Accountant General/Joint Secretary/Secretary. In between different spells in the Pool, the officer would spend a certain period in his parent department or elsewhere. For instance, between Assistant Accountant General/Under Secretary, and Dy. Accountant General/Deputy Secretary ranks, there might be a spell of four years outside. Similarly a spell of five years between the Deputy Secretary/Deputy Accountant General and Accountant

General Joint Secretary/Secretary ranks. Thus if an officer enters the Finance, Accounts and Audit Pool at the age of 35 (after a period of training,) he will go out again at the age of 38. He will return, say at the age of 42 and go out at the age of 46. He will come back at the age of 51 after which he would be available, wherever required, according to the needs of governments. If such a system is adopted, then the criticism that Finance, Accounts and Audit men do not know administration would be obviated. Even if the criticism is not true, it would be of great psychological benefit to have in the Finance, Accounts and Audit Pool men who have wide experience of various departments. They are more likely to be listened to. This system would also meet the reported criticism of Dr. Appelby about the lack of reality of finance, accounts and audit staff and also perhaps ensure both better financial audit and proper efficiency audit or "khozaschyot".

For financial advisers-cum-chief accounts officers, state auditors and resident audit officers as well as officers working under them, a general knowledge of accounts and audit procedure is all that is necessary. It is not necessary for them to have spent years in the various accounting sections. A suitably short period of training would, therefore, be adequate. But they should have expert subordinate staff well versed in procedure. Hence, the cadre of Superintendents in all offices of Financial Advisers-cum-Chief Accounts Officers as well as State Auditors and Resident Auditors should consist of men who have passed the necessary departmental examinations like the Subordinate Accounts Service Examination. This cadre should, of course, be under the Comptroller and Auditor General of India. Otherwise, there may not be that unity in accounting, etc. matters all over India which the existence of a unified Plan makes desirable. Officials below the rank of Superintendent can be recruited locally and paid for locally, as far as possible. There should be a quota in the Finance, Accounts and Audit Pool for promotion from S.A.S. men. They should be promoted fairly early, say between the ages of 30 and 40. On promotion, they should spend some time in administrative departments and in the districts, and then be treated like other officers of the Pool.

It should also be a convention that State Auditors and Financial Advisers-cum-Chief Accounts Officers be not posted in their parent States. For instance, a Finance, Accounts and Audit Pool man belonging to the Indian Administrative Service and allotted to Orissa or a Public Works Department Officer of the Orissa State, appointed to the Finance, Accounts and Audit Pool, should not be posted to Orissa in the capacity of an officer of the Finance, Accounts and Audit Pool. They may be posted in Bihar or Madhya Pradesh or in any other State. After serving their terms there, they will go back to Orissa. This would ensure independence without their being embarrassed or later penalised, for such independence.

The Finance Secretary would, of course, continue to be, if desired, a man drawn from the general administrative services, as at present.

So far as public corporations go, the system delineated above would also be better than the present one and might be an answer to the point regarding the unsuitability of government auditors raised in Chapter 9 above. It should also be considered whether there should not be a quota of men drawn from good firms of Chartered Accountants, who might be absorbed in the Finance, Accounts and Audit Pool and in general administration. This will further help in preventing the alleged "mechanicalness" of finance, accounts and audit men.

Flexibility being the key-note of the system, officers in this Pool can be interchanged with officers in other Pools. For instance, the proposed Industrial Management Pool.²

How does all this impinge on democracy? The effect in this case will not be direct but indirect. There have been many attacks on the present instruments of democracy in the Executive, *viz.* finance departments and audit. The proposed changes would imply the refashioning of the instruments to serve the needs of a Development State in place of those of a Law and Order State.

Conclusions. The Law and Order State has changed to the Development State. The old instruments of democracy

² *The Hindustan Times*, Delhi, January 24, 1957.

in the Executive Government, *viz.* the finance departments and audit would, therefore, have to be refashioned to suit the new times. A flexible Pool, consisting of men drawn from different Services, might provide the personnel requirements at higher levels (officer level). Such a Pool of men of varied experience will also mitigate "mechanicalness" in finance and audit processes. Psychologically also, such officers of a Pool are more likely to be listened to than specialist officers in accounts, finance and audit processes. Adequate safeguards would have to be made for their independence. Flexibility in transfers between different Pools would increase the usefulness of all the officers involved. They would also then be better servants of democracy as they would possess wide experience, and hence be of greater use to various legislative committees which they might assist.

SHORT-TERM AND LONG-TERM FINANCIAL PLANNING

Ours is now a planned economy although our type of planning is different from those of the U.S.S.R., China and East European countries. Each country has to develop its own methods of planning. The budget has to fit into the Plan, as discussed in Chapter 5 above. In other words, the "sacred" period for budgetary computations would no longer be the year but the five-year period. The annual budget would be "sacred" but this "sacredness" would be less than that of the five-year period.

The Plan, however, is only the paper picture of long-term objectives. Such long-term objectives have to be made clear to the public, if they are to bear all the requisite burdens and sacrifices. If this is to be done, then the long-term objectives themselves would have to be given concrete shape. It may not be humanly possible to think of the future for beyond 25 years or so. Within this 25 year period (or the period of a generation), each Five Year Plan should fit in as neatly as possible. In other words, there would have to be "perspective planning" with a wide "time horizon". Professor P. C. Mahalanobis says in this regard:—

"Perspective planning would be primarily concerned with the technical and scientific aspects of long-term growth of economy. Studies and researches would be directed to solving practical problems and would be broadly of the type of "operational research" although some problems of basic research would no doubt arise from time to time). This would call for the active co-operation of a large number of engineers, technologists, economists, statisticians, and workers in practically all fields of both natural and social sciences".¹

¹ *Sankhya* the Journal of Statistics, Volume 16, Parts 1 & 2, December, 1955, p. 60.

It is doubtful whether the long-term perspective planning can be done in the existing organs of the Central or State Governments or in divisions of the Planning Commission engaged in day-to-day work. All these organs are engaged in operational planning. Long-term planning has to be free from the day-to-day expedients of short-term planners. Hence, a separate organisation or a separate division in the Planning Commission for long-term planning seems to be necessary. Long-term financial planning would be part of its functions. Of course, the results of this long-term planning would change with changing circumstances. For instance, new scientific and technological discoveries might make possible better production methods. The atomic energy scientists at Trombay may discover new methods of harnessing the atom for peaceful purposes in an inexpensive manner. Such an eventuality will give rise to whole series of new circumstances. When such things happen, the whole long-term planning as well as short-term planning would take new shape.

All that is being advocated is the idea that it will not be a luxury to have a few men and women, out of 400 million people, devoting their energies and time in an organised manner to the collecting of thoughts of people from within all over India as well as from outside, with a view to seeing how India can become one of the foremost nations in the world in the shortest possible time. Long-term financial planning would be but a part of this all-round long-term thinking. It is interesting to observe that the "Eastern Economist", in its Annual Number, 1956, has engaged itself in such "perspective planning" and that a chapter is devoted to national income and money supply.

FINANCIAL PROBLEMS AND THE PUBLIC

At present, high finance is regarded by laymen in India as something esoteric. It is common knowledge that very few public men have much understanding of economic and financial affairs. This is not to say that there are not in India a great number of businessmen who know how to become rich; nor, professors of economics in universities who can quote from the latest economic journals. But that what is erroneously known as "high finance", that is to say, public finance, with its direct impact on the day-to-day lives of citizens, seems to most people in India extremely dull and boring. Matters are different in the U.K. and in the U.S.A. where a great number of people have the necessary basic knowledge about public finance matters. The citizens of a poor undeveloped country like India, trying to catch up with the advanced countries of the world, would have to be even more economic and finance-minded, if rapid economic progress is to be achieved. A few suggestions to achieve this aim are made below:—

- (a) the legislatures might have special economic information organisations attached to them, which would issue periodicals and pamphlets;
- (b) the Audit Reports, if revised in the manner suggested in chapter 11, might also be placed before the public in the form of press hand-outs; and
- (c) the meetings of the Public Accounts Committees might be held, as far as possible, in open and not in *camera*.

Publicity literature helps a lot in education. If in each legislature there is an economic affairs information organisation consisting of teams of men versed in finance, economics and journalism, then they could bring out journals at regular intervals as well as topical pamphlets. These could be distributed free, if necessary, to members of the legislature and to the Press. These teams could also attempt to answer queries of legislators of an economic and financial nature.

If there is budgetary reclassification and more and more "khozraschyot" activities, then Audit Reports might profitably be rearranged as suggested in Chapter 11 above. If this happens, then the economic information organs attached to various legislatures, as suggested above, might well bring out succinct and lucid press notes, embodying, in popular language, the main points of Audit Reports. If necessary, Press Conferences might also be held. There is no real reason why all meetings of the Public Accounts Committee should be held *in camera*. The finance departments and audit officers are essentially the representatives of democracy within the executive. There seems to be no reason why mid-Victorian British ideas should predominate in the twentieth century India of economic planning and the touch of the public scrupulously avoided.

CHAPTER 15

SOME PROPOSALS MADE BY MR. ASHOK CHANDA, COMPTROLLER AND AUDITOR GENERAL OF INDIA

What are known as the "Chanda Proposals" are secret. Mr. Chanda, however, has proposed certain innovations in various public speeches. It seems to the present writer that such innovations, if carried out, would streamline the present administration and make it better fitted to serve the needs of democracy. Many of the suggestions in question have been referred to in the previous chapters. For the sake of convenience, however, these are brought here again and some other suggestions which have not been dealt with are also considered.

Suggestions already considered in the previous chapters—

- (a) The budget should continue to be compiled on the present basis but should be considered as only the budget plan to give the Parliament a broad picture of the Government's scheme of expenditure. Demands for grants should be based on—

- (i) standing charges, including maintenance;
- (ii) expenditure on current projects; and
- (iii) a small provision for each new project. Supplementary demands should be presented as and when schemes mature sufficiently and are ready for execution.

- (b) Financial scrutiny should be in two parts—

- (i) Broad and overall scrutiny located in the Finance Ministry, and
- (ii) Detailed scrutiny, at expert level located within the administrative Ministries.

- (c) The administrative Ministries should be provided with internal Financial Advisers drawn from a panel of officers with financial experience (as approved by the Finance Minister). Technical advice should be made available by

suitable adjustment in the strength of the present Industrial Advisory and Development Wing under the administrative control of the Commerce and Industry Ministry. This organisation should be treated as a common pool for purposes of giving technical advice to the administrative Ministries.

(d) The Planning Commission should fulfil its responsibility of reviewing quarterly, the progress of projects included in the Plan, in consultation with the administrative Ministries concerned. Default or failure should be brought to the notice of the Chairman, Planning Commission, for such action as he may consider appropriate.

(e) In lieu of the Centre rendering financial aid to the States for a proportion of the expenditure on all the approved schemes, they should accept full financial responsibility for a specified number of such schemes, up to an equivalent amount. Programme Advisers should be required to report that the remaining schemes have been undertaken by the States out of their own resources.

(f) Detailed scrutiny of States' scheme should be discarded. The examination by the Centre should be confined to—

(i) a broad administrative scrutiny by the Ministry concerned and the Planning Commission, to ensure that they fall within the framework of the Plan, and

(ii) a broad financial review based, mainly, on the certificate of the States Finance Department, that the schemes have been drawn up in accordance with standards, schedule of rates, etc. prevailing in the States and as are applicable to States' schemes.

(g) There should be de-concentration of authority in favour of Executive and Project Officers at all levels appropriate to their responsibilities and status.

(h) Internal Finance Officers should be associated with the delegation of authority, wherever necessary.

(i) A schedule of sanctions should be prepared by every officer for submission to the authority immediately

superior to him, to enable a review of the manner which delegated powers have been exercised.²

Other suggestions. Many of the more general ideas of Mr. Chanda have been incorporated in various suggestions in the preceding chapters of this book. Thus, for instance, the concepts of the identity of interests between administration and audit, the roles of internal and external audit, the need for the reorientation of the outlook of services to serve the needs of a Development State, the necessity of varied experience among all officers at higher levels and so on. Four new specific suggestions are considered here:—

- (a) the resuscitation of the All-India Technical Services;
- (b) the giving of more importance to "field" than to Secretariat posts;
- (c) specialisation in cost accounting and economics of production; and
- (d) necessity for a High Powered review of the whole administrative system.

As regards the resuscitation of the All-India Technical Services, Mr. Chanda says:—

"The relations between the Union Government and its constituent units must necessarily be fundamentally different from the relations between the Central and the Provincial Governments under a foreign rule. They must be more intimate and the conception of autonomy adjusted and moderated by the co-ordinating influence of the Union Government. Further the tempo of the first Five Year Plan progressively increase both in volume and intensity, with successive Five Year Plans underlying the urgency of this problem. The remnants of the All-India Services in the development field still continue to be the backbone of the technical administration, both in the States and in the Centre. The stage is fast being reached when the extinction of these Services will become a reality, imposing, what is already visible, a strain, almost to the breaking

² *Central Government Audit Report (Civil) 1955, Part I, pp. 37-39.*

point. The question of resuscitating these Services on all All-India basis requires, therefore, immediate consideration".³

Mr. Chanda has pointed out that the non-recruitment to the technical services on all all-India basis is but a fortuitous side-development of our desire, during British days, to take out as many Services as possible from the direct control of the Secretary of State. His observations are as follows:—

"A strong pressure had developed for the Indianisation of the Services as a part of the larger demand for Self-Government. With the introduction of the first instalment of Reforms in 1919, the Secretary of State considered that the continued control of the Services in the "transferred" fields vesting in him would be anomalous and should be discontinued. This feeling was reciprocated by the political parties and the more formal provincialisation of the Services found ready acceptance. The incidental advantages of recruitment of suitable candidates, on a wider all-India basis, to the technical services thus came to be lost. Although provincial autonomy was theoretically fully conceded in the 1935 enactment, special responsibilities in respect of law and order and the control of the Services were vested in the Governors, to be exercised at their personal discretion and individual judgment. The executive instrument for the administration of law and order—the I.C.S. and the I.P.—were, for these reasons, retained under the control of the Secretary of State. Under this reservation, control in the vital field of provincial administration was not diluted by the grant of autonomy. With the progressive Indianisation and the corresponding elimination of the British element, the Secretary of State's real interests in the control of the other Services waned. Provincial autonomy served, however, as the osten-

³ *Inaugural Speech at the Annual Meeting of the Class II Officers' Association of the Indian Audit & Accounts Department, 4th February 1956, p. 11.*

sible reason for discontinuing the all-India Services other than the I.C.S. and I.P. The Imperial power was, primarily, interested in retaining its hold on the country, and had no inherent interest in maintaining its unity. As the movement for self-government gained momentum, it was found expedient to foster strong provincial feelings. Therefore, the policy was to strengthen the Provinces at the expense of the Centre, except in the field of law and order, so vital to it. The main object of retaining control over the effective administrative field was secured by excluding the I.C.S. and I.P. from the scope of disintegration".⁴

The States Reorganisation Commission have also advised the reconstitution of certain technical services on an All-India basis.⁵ They have observed that the Central and State Governments "have to work in very close co-operation in executing important development projects, which necessitates that technical personnel should be recruited and trained on a common basis and that they should have uniform standards of efficiency and the feeling of belonging to common and important cadres".⁶

In a Development State, where the application of science to the needs of society is the most important task, scientists and technicians should be more honoured and rewarded than any one else. If this logic is admitted, then the pay scales of government scientists and technicians should be weighted in their favour rather than in favour of the administrative services. This will ensure that the best men and women go in for scientific and technical lines. Simultaneously, it seems to the present writer, the advice of the States Reorganisation Commission should be heeded so that there is unity in technical information and technical procedures all over the country. This is the position in the U.S.S.R., where technical men and scientists are more honoured than others, except small groups like writers, ballerinas, etc. In fact, the logic behind having well-paid All-India Administrative,

⁴ *Ibid.*, pp. 8-9.

⁵ *Report of the States Reorganization Commission*, paras 856—and 857

⁶ *Ibid.*, para. 856.

Accounts, etc. Services instead of high-salaried All India Technical Services is by no means clear. The present system was understandable in British days when law and order were the main preoccupations, the development of the country relatively unimportant, and the Indian Civil Service, predominantly British, a governing corporation, as Sardar K. M. Panikkar has reminded us.⁷ This governing corporation then gave the necessary element of unity to the administration of the country. That unity is now being provided by the democratic processes of administration and by political leaders. The responsibilities of the administrative services have, therefore, decreased. In any case, they are not responsible for the political unity of the country. On the other hand, it is obviously necessary that comparable technical standards should prevail all over the country, if development is not to be lopsided and if the tax-payer is to get an adequate return for his money.

In the Indian system, Secretariat officers get more honour and emoluments than "field officers". Mr. Chanda says in this regard:—

"The role and importance of executive officers in charge of our major projects clearly demand that there should be a judicious distribution of available talent between the policy-making authority and the field organization. The attractions of status and salary, which Secretariat posts now have should, therefore, be adjusted to take into account the change in emphasis between administrative posts in headquarters and executive posts in the field. As early as 1945, an experienced administrator, while reviewing the organisation of Government, came to the conclusion that the difference between the pay of Secretariat and District officers—should be lessened. The justification of removing the disparity is far greater now when the accent is on having the more competent officers

⁷ Sardar K. M. Panikkar, Srinivas Sastri Lectures 1954-55 (Madras University) *Civil Services, History and Problems*, pp. 41-42.

in charge of our field projects".⁸

In the old days there was some reason why pay in the Secretariat should be higher than the emoluments of field workers. As control from Whitehall was remote, the Secretariat constituted the day-to-day governing corporation. They were, therefore, not only administrators, but political rulers. This "political leader" aspect of the administrative service has ceased. There is no reason, therefore, why the higher pay which went with the political leadership should continue to exist. Obviously, a factory manager does more important work than most aides of a Minister. If logic is to be followed, then more pay should be given for important executive field posts than for those of most Secretariat aides.

Mr. Chanda has also referred to the necessity of "building up gradually a corps of technical Cost Accountants, who would be competent to challenge and disallow any abnormal margin of wastage of raw materials or of excessive utilisation of machine or man-hours in the computation of costs".⁹ The idea behind is that "our production both qualitatively and quantitatively, as also in price levels, must compare favourably with supplies from elsewhere".¹⁰

A development of the above ideas of Mr. Chanda regarding costing accounting leads to the concept of thorough-going "khozraschyot" or scientific evaluation, in some form or other. This has already been dealt with in previous chapters. There would really be no harm and perhaps much gain in studying the techniques of "khozraschyot" activities in other countries like the U.S.S.R., China, etc.

Mr. Chanda has suggested the necessity of a High Powered Commission to effect a "complete reorientation in the structure of the country's administration".¹¹ He has cited the example of the Royal Commissions which have been appointed from time to time in the United Kingdom to

⁸ *Inaugural Speech at the Annual Meeting of the Classes II Officers' Association of the Indian Audit & Accounts Department*, 4th February 1956.

⁹ *Convocation Address*, 1956 at the Institute of Cost and Works Accountants, 21st December 1956, p. 2.

¹⁰ *Ibid.*, p. 4.

¹¹ *Amrita Bazar Patrika*, December 24, 1956, p. 12.

review the efficiency of the administrative machinery. In India there has been no such review. Sir Chintaman Deshmukh, the former Finance Minister, and himself an old-time civil servant, has also, in a completely different context, suggested a review. For instance, in a speech before the Institute of Public Administration, Patna University on October 7, 1955, he stated *inter alia*:—

“Then, three years after independence, the idea of planning, and following it, that of a socialistic pattern of society, came in. And all this, it should be remembered, took place within a framework of constitutional parliamentary democracy, which meant that the executive was responsible to the chosen representatives of the people, and that the bureaucracy was subordinate to this executive. Now, this brought about a complete change in the character of the control exercised on the administration. This was in addition to the increased complexity and the specialised nature of the work entrusted to it. There was an increase in the demand for experts and the need to co-ordinate the work of the expert and the general administrator. This state of affairs has made a review of the whole situation very necessary”.¹²

He was also, in that speech, apparently very pessimistic about the quality of our administration in the future. He stated:—

“I have by now wandered round in the world a good deal in the course of my professional duties. I have no confidence that, if we go in the way in which we have been going on, we shall be able to hold our own with the citizens of other countries in regard to the quality of our administration”.¹³

Does not the fact that two such eminent people have thought a thorough review of the administration to be necessary indicate that we should follow the British practice of having periodical Commissions to go into the question of the administrative machinery, and one to start with, as soon as possible?

¹² *Bulletin of the Institute of Public Administration*, Patna University, January 1956, p. 9.

CHAPTER 16

CONCLUSIONS

At a certain seminar of officials from many parts of India, which I attended, a senior official got up from time to time and opposed practically all changes suggested by different speakers. The reason for this was not quite clear until he came out saying that too many changes would "make confusion worse confounded". This doctrine of "confusion being made worse confounded" by changes, deserves some serious notice. It is understandable that many bureaucrats and desk-men would dislike changes in the administrative system as would upset their routine and schedules. Since much of the day-to-day administrative processes depend on routines and schedules, there is abundant reason why these should not be changed frequently. The achievement of greater efficiency might be one reason which may prompt changes in the administrative system. This is the bureaucratic reason, although changes to attain greater efficiency have general all-round effects. Another reason for change, which would be applicable to new democracies like India, would be to make the administrative system more in conformity with the needs of a democratic state, of a development state. If the proposition that the old British system of administration should be changed to fit in with the needs of the new democracy is admitted, then it is difficult to see why the idea of change as such should be opposed as "making confusion worse confounded". If it is feared that there is lack of a sufficient number of experienced men to prevent temporary confusion, then the logical course would be to phase the changes rather than eschew them together.

The concluding proposition in the preceding paragraph is based on the assumption that democracy is good in general, is good for India, is suited to the Indian temperament and that everything should be done to foster democracy in this country. Before Independence there were quite a number of people, both Indians and foreigners, who scoffed at the idea of India having a really democratic system of government. They said that India has always been governed by

Maharajas and Nawabs and that the Indian temperament, so obsessed by the concept of caste, is not favourable for democracy. This is not quite true. Early in Indian history there were democratic republics like the Lichchavis of Vaisali, the Mallas of Kusinara and so on. These republics were as democratic as Athens. Of course, our present democratic ideas are derived mainly from the West, chiefly from the ideals of the French Revolution and from British practice. There has been no continuity with the republics of Vaisali and Kusinara or the democracy of the Buddhist Sangha. Nevertheless, the fact that these democracies existed would prove that it is untrue to say that democracy is unsuited to the Indian temperament. Thoughtful, purposive and determined leaders can undoubtedly change the motivation-pattern of a society and the avowed desire of our leaders is to change our motivation-pattern in general so as to make the country more and more democratic. Indeed, it would be dangerous in a heterogeneous country like India to even think of a dictatorship. A dictatorship would ultimately lead to the dominance of the linguistic group most powerful at that time, periodical attempts of other groups to shake off the yoke of the most powerful group and consequent strife. If such things happen, then will the so-called bonds of common training between members of the non-technical Services be strong enough to hold together the fabric?

If, therefore, we should have more and more democracy, then how best would one achieve this aim? The Indian Constitution is there and it lays down the basic framework of our country's administration. But under the umbrella of the Constitution various democratic institutions have to emerge in each new period of endeavour. In this book it is this latter question of institutions which has been dealt with and that too limited to financial institutions.

The foremost necessity is obviously that the electorate and the legislatures should be fully informed of financial and economic matters. Hence, the suggestion that Economic Information Organisations should be attached to legislatures, consisting of teams of expert men and journalists. Such Organisations should bring out periodicals and pamphlets.

If necessary, these can even be distributed free, and as widely as possible. The cost would be well worth the while.

Such Organisations should have close links with the Press. The Press always plays a very important part in democracies, and, generally speaking, a very noble part.

Coming to institutions, the basic proposition is that the head of a department, the minister, as well as the civil service head, should be responsible for finance, accounts and internal audit. This is the position in all good firms. The acceptance of this proposition would logically lead to the separation of accounts from audit. Separation means more cost and would also lead to the dilution of trained personnel. Hence the change may have to be phased, but it would not be logical to oppose the idea of this change. The acceptance of the idea of separation of accounts from audit would, in reason, lead to the adoption of the financial adviser-cum-chief accounts officer system for big projects and departments and for groups of other departments. These officials would be knowledgeable servants of Estimates Committees and their Sub-committees. A necessary concomitant of the separation of accounts from audit would mean that auditors, as far as possible, would be resident auditors, drawn from the general administration itself. The officers dealing with finance, accounts and audit should, therefore, be members not of water-tight services but of a "Pool". The officers of this Pool can be interchangeable with officers of other government Pools. There would thus be unity in administrative procedures and practices. These Pool officers of varied experience would be listened to when they evaluate and offer constructive suggestions. Most important of all, they would be more effective servants of the Estimates and Public Accounts Committees and their Sub-committees.

If budgetary classification is changed so as to follow strictly functional heads, and made to accord with the classification which has been adopted for the Plans, then both the budgets, and the appropriation accounts, (which indicate how far the budgets have been followed) would be more intelligible to laymen and legislators. The number of heads being fewer, the budgets and the appropriation accounts would be smaller documents and hence fitter for submission to legislatures than

the present bulky ones, *pace* Dr. Appleby. Also, as the number of heads would be smaller, the executive would have more elbow room in taking money from one unit to another within the same functional head. There would thus be both better democratic control and more executive freedom.

With such a changed system, and with men of wider and varied experience, scientific evaluation, or "khodzroschyot" activities, can be given greater and greater importance. It would be profitable in the meanwhile to see how "khodzraschyot" activities are being carried out in other countries, where the economy is either largely government-controlled or is government-organised. Not only U.S.S.R., China, etc. but also France and the U.K. might be countries where scientific evaluation may be studied.

Short-term planning is not adequate. There has to be a window to the world of inventions and of basic thinking. Only then can realistic long-term plans covering 25 to 30 years be framed. Of course, such long-term plans would be very broad, and flexible. Within this long-term plan short-term plans can be fitted in every quinquennium. The advice of Professor Mahalanobis regarding long-term planning has not come a day too early.

There would seem to be a strong case for the resuscitation of the All-India Technical Services. As Mr. Ashok Chanda, the Auditor General of India has pointed out, recruitment to the technical services on an all-India basis was given up because at one time we were against Services being recruited and controlled directly by the Secretary of State. As a consequence, we have the anomaly that the administrative and police services are All-India Services, while the technical Services have been mostly provincialised. In logic it should be the other way about. India is no longer merely a Law and Order State, but mainly a Development State, where the element of political unity has not to be provided for by a governing corporation of administrators-cum-political leaders, but by statesmen and politicians elected by the people. All-India administrative and police services to ensure the unity of India is, therefore, an outdated idea. This is not to deny that the I.C.S. consists, by and large, of some of the most talented and experienced men in the country. That,

however, has nothing to do with the argument of this paragraph.

Mr. Ashok Chanda has reminded people that in the U.K. there are periodical Royal Commissions to review the machinery of administration. Sir Chintaman Deshmukh has also admitted the necessity for review. He has not made any specific suggestions as to how the review may be conducted. But a High Powered Commission (*i.e.* consisting overwhelmingly of prominent non-officials) seems to be the obvious solution. If such a High Powered Commission is set up, there can be little doubt that, as a result of its labours, an administrative structure better suited to the Indian democracy of tomorrow would emerge, a structure which would enable everyone to serve better the New India of which we are so proud.

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