

● GOVERNMENT FAILURE

WHEN THE ESTIMATE ITSELF IS QUESTIONABLE, SHOULD WE BE UNDULY CONCERNED ABOUT SLIPPAGES OF ONE OR TWO DECIMAL POINTS?

Ensuring budget transparency & accountability

OVER THE YEARS, the various “innovations” made to contain deficits have cast serious questions of credibility. While the credit rating agencies and economists rant about the slippage of a few decimal points, we merrily go about pretending that these numbers are indeed accurate and fail to question the several adjustments made to conceal the real numbers.

Although the government will be presenting only an interim budget or a vote on account on February 1 of next year, there is much concern that there would be slippages despite the assurance by the finance minister that the numerical fiscal deficit target of 3.3% of GDP will not be breached. The shortfall in GST collections is estimated to be ₹1 trillion and disinvestment revenue could fall short of the ₹800 billion by 20%. On the expenditure side, additional subsidies for oil and fertilisers could be substantial though, thankfully, the lowering of the price of crude oil will limit its escalation further. It is estimated that there will be additional expenditures of ₹200 billion on account of the new minimum support prices and an additional ₹20 billion for Air India over and above the ₹163 billion provided for in the budget. Additional expenditures will also have to be provided for Ayushman Bharat. The speculation is that the government will resort to time-tested ways of “conforming” to budgeted estimates.

Given the pressure on both revenue and expenditure sides, it may not be surprising if the finance ministry resorts to a lot of window dressing and creative accounting. When the estimate itself is questionable, should we be unduly concerned about slippages of one or two decimal points? In the past, failure to adhere to fiscal targets was only a part of the problem. Redefining the targets, shifting the goal posts time and again, making adjustments by compressing growth-enhancing expenditures and resorting to creative accounting have all been practiced as also the postponement of the payment of bills. Much more serious are the

attempts to obfuscate the forecasts of revenues and expenditures, collecting revenues in advance, creating disinvestment revenues through inter-enterprise purchases and the mandating of healthier public enterprises to bail out the weak ones.

All these have serious adverse implications for budget management. Nor have the contingent liabilities arising from various commitments of the government, including public-private partnerships, been properly recognised. The thirteenth Finance Commission, after reviewing the experience of fiscal adjustment, had underlined the need for actions to make the Union budget more transparent and comprehensive, sensitive to exogenous shocks and that which contained improved monitoring and compliance. Although the recommendations to achieve these have been made about a decade ago, Union budgets continue to suffer from the crisis of credibility.

The problem with budgeting begins with overestimating revenues and underestimating expenditures. Overestimation in income tax revenues, for example, results in the setting of unrealistic targets which is divided amongst the collectorate. The officials whose performance is judged by the ability to achieve the revenue targets make exaggerated demands and the taxpayers are required to pay 50% of the assessed amount immediately. The CAG's report on direct taxes states that 65% of the cases in Tribunals, 79% of the cases in High Courts

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and 71% of the cases in the Supreme Court are decided in favour of assesseees and the amount of interest paid on account of this by the government in 2015-16 worked out to ₹800 billion! The report of the CAG on the compliance of the Central government with the FRBM Act shows that the unpaid bills in 2015-16 amounted to ₹1.87 trillion. We have seen the case of ONGC buying shares of HPCC to transfer the money to the government as disinvestment. We have also seen LIC being made to bail out IDBI, and more recently, IL&FS. Never mind the interests of the non-governmental shareholders of ONGC and the policyholders of LIC. Even with all these, we continue to treat the deficit targets as sanctimonious!

A budget is a document translating government policies into actions.

Restoring its credibility by making it comprehensive, transparent and realistic is important in a democratic polity. This requires a number of reforms by the government. Measures like fixing the numerical fiscal targets to calibrate rule-based fiscal policy through the enactment of fiscal responsibility legislation and annually adjusted medium-term frameworks are only the first steps for rule-based fiscal policy. Transparency and comprehensiveness requires significant reforms in budgeting. Realistic forecasting of revenues and expenditures should be made a priority. In addition, the thirteenth Finance Commission has recommended a number of measures such as the presentation of economic and

functional classification of the budgets, presentation of a separate statement on the transfers to states, more scientific estimation and reporting of tax expenditures on major tax concessions, working out and presenting the compliance costs of tax proposals, details of capital expenditure proposals and their revenue consequences, and comprehensive assessment of contingent liabilities including the liabilities arising from PPPs.

The most important reform which the government must take up expeditiously is to switch over to the accrual accounting system. This is one of the important recommendations made by many of the past finance commissions which has not been implemented. Many countries are making the transition to an accrual-based accounting system and considering its importance, G-20 countries are deliberating on this issue in Buenos Aires. Nearer home, even countries like Malaysia have taken up the task and will adopt the system in the next three years. Of course, this cannot be done overnight. A lot of preparatory work has to be done before switching over. Surely, this is a reform that should be implemented to enhance transparency.

When the markets fail, governments intervene. How do we minimise the problems of government failure? Inability to contain the deficit and debt as set out in the FRBM targets is a clear case of government failure. To create checks and balances for this purpose, we need innovative institutions. Parliamentary oversight is important but that is effectively done by institutions such as the Fiscal Council. More than 30 countries have adopted this practice and many more have been embracing this, particularly after the global financial crisis. The Council, appointed by the Parliament, should be reporting to it. The mandate of the Council could be initially confined to the evaluation of the realism of budget forecasts, monitoring of the implementation of rule-based policymaking and costing the various policy pronouncements made by the government from time to time. Such an institution will enhance both transparency and accountability.

