Innovative Budgeting and Effective Implementation

OBJECTIVES

This exercise of considering suggestions to improve our structure of budgeting, implementation of schemes & project and tax administration has been done with a view to principally focus on efficient and speedy implementation of Government schemes. With this background, the existing budgetary practices and rules have been examined to ensure that resources are available in time to implementing agencies to enable them to undertake their work speedily and efficiently. On the same lines, the group has considered and recommended suggestions to improve and strengthen our framework to monitor the implementation of the schemes. The suggestions on tax are motivated principally towards simplification and ease of compliance while ensuring adequate Government revenue. At the same time, the private sector should be incentivized to cooperate with the Government both in contributing revenue and resources for public development. In short, the objectives may be summarized as:

- Timely availability of funds without wastage and parking
- Effective and speedy implementation
- Stimulate savings and investment through tax reforms

A. INNOVATIVE BUDGETING

1. Advance the Budget cycle and present Budget by 31st December (2017-18)

1.1 The present budget cycle implies that the budget is typically passed by end April/early May, and funds are made available to implementing agencies usually by June. This, and the fact that June marks the arrival of the monsoons, leads to further delays on the ground. The expenditure targets being benchmarked for the first quarter and the half year imply that there is an incentive created for parking of funds. This chain can be cut short if the ability to spend can be timed with the financial year and relevant authorisations be in place by 1^{st} April. This is achievable if the budget is passed with Presidential authorisation before the end of March. One way of achieving this is to have the budget presentation moved up from 28^{th} February tothe middle of December. This can be done by re-classifying the winter session as the budget session, and incorporating the President's speech in the same session.

1.2 There are some technical implications involved in thischange which are discussed below:

First: Typically indirect tax proposals take effect immediately, after the budget announcement, so as to limit tax arbitrage. Introducing them in December will significantly change the revenue assessment for the current year as the changed taxes will operate for over 3 months as against one month at present. But these can be estimated and included in the Revised Estimates presented along with the budget.

Secondly, as the budget data will be effectively based on six months data as against nine at present they will have a higher degree of error. This can be easily accounted for by the FM incorporating updated revenue and expenditure figures in his final response to the budget discussion.

Third, at present the economic survey is presented just before the budget and this is based on data for 9 months. The shift to December will imply a readjustment, but this can be accommodated by converting the mid-year assessment into an economic survey. Similarly CSO provides an estimate of GDP for the Financial Year by February, which is the basis for the budget estimates of fiscal deficit to GDP ratios etc. This can be also accommodated by using the half year estimate provided by CSO by the end of November.

2. **Along with budget of one year, include a provisional budget for the subsequent year (2017-18)**

Long duration capital investments as well as capital investment decisions which have a long planning horizon, suffer from the current unpredictability in fund availability. This can be alleviated by adding an extra column in the budget document which includes a provisional allocation for the next year as well. This will not entail significant additional work as most departments still make this assessment as part of their budgetary exercise. Including it in the budget document increases commitment value and would not require any constitutional change as it is a provisional statement and is not voted for in the actual demand for grants. However for the implementing agencies the reference in the budget will make for greater assurance. (Based on this experience, the possibility of more formal multiyear budgets, which would require constitutional changes, can be examined)

3. **Plan/ Non plan distinction may be removed (2017-18)**

The Plan and Non Plan distinction has been criticized extensively and does not need elaboration. The only concern that arises from its removal is the fact that departments have at present made plans and proposals extending till 2016-17, the last year of the 12th five-year plan. Thus the group would recommend that this be implemented with effect from the budget cycle of 2017-18. The distinction between plan and non-plan had created a number of unhealthy practices in expenditure and project management. However its abolition raises queries of whether this will appear to dilute the governments focus on development. It is felt that this is not the case, as the abolition will restore the focus correctly on the revenue and capital account. The share of expenditure on capital is more closely related to the development dimension. Thus it is hoped that the emphasis would be on assessing how much resources would be available for capital expenditure.

The concern for a loss of visibility on social expenditure will be addressed in our subsequent point.

4. For major multi-Ministry policy initiatives, a consolidated statement for each subject/ activity to be made part of budget documents (2016-17)

The Government in a number of areas has announced and is implementing initiatives that cut across different ministries and departments. This includes, but is not limited to, Swacch Bharat; Skill India; Farmers Welfare; etc. The degree of such inter-ministerial resources and their complementarity are not readily known even to implementing ministries. At present the budget document includes statements on cross cutting themes like the North -East allocation, Gender and the SC & ST sub plans. We would suggest that on these lines, we provide consolidated statements on all major multi-ministry flagship programs. This will facilitate both inter-ministerial coordination as well as public awareness of the scale of the initiatives. This can be done from the ensuing budget itself.

5. Medium/long term macro-economic goals to be set by a collaborative process among Niti Aayog, Finance and Administrative Ministries (2016-17)

Subsequent to the abolition of the Planning Commission, there is a need to develop a medium horizon macro policy framework, within which ministries and departments can make their own proposals. This will need to be a collaborative and consultative exercise between Niti Aayog, Finance and the Administrative Ministries. It should be initiated immediately so as to provide necessary guidance to Ministries in framing their expenditure proposals for the 2017-18 budget cycle, and onwards.

6. Outcomes to drive Budget

An outcome driven Annual Action Plan for the forthcoming year should be drawn up six months before the finalization of the Budget by Administrative Ministries, and three to five measurable priority outcomes and activities necessary to achieve these outcomes be identified in the Action Plan. These should be reviewed and agreed to at an appropriately high level; perhaps the PMO/ Cabinet Secretary. These identified priority outcomes should be part of the Budget, and the agreed activities needed to achieve the outcomes should be funded as per their requirements in the Budget.

7. Zero based budgeting

Existing budgeting practices has schemes and projects continuing year after year, sometime with long delays and cost over runs and no foreseeable date of completion. In many cases, cost escalation takes place without a complete assessment of the desirability of continuing with the project/scheme in the current situation. With a view to rectify this, following is suggested:

a. All new schemes/projects must provide for a zero based mid-term review, timelines for which are not to be changed under any circumstances. The review, if it recommends continuation of the project/scheme must also indicate the date of the next review. This would certainly bring about clarity and improve implementation of new schemes and projects.

b. Separately, as a onetime measure it is necessary that Ministries and Departments be directed to take a zero based review of all existing projects and schemes (all major lines of expenditure in the budget including all institutions). This review should recommend continuation only if their future continuation is justified on the basis of a current assessment of costs and benefits ignoring all past costs as sunk as well as indicating a time frame for the next review.

8. Amend FRBM Act to move from annual fiscal deficit target to medium term fiscal prudence goals, with a limit on overall debt to GDP ratio

The FRBM Act was enacted with a view to institutionalise fiscal discipline, improving macroeconomic management and the overall management of public finances. The Act therefore, provide a timeline under which both revenue deficit would be eliminated and fiscal deficit sought to be kept at a "manageable" three percent of the GDP. The operation of this Act was suspended in 2009 and the deadline subsequently revised. The Act has been criticised in the past for creating significant hurdles in public policy. The principal argument has been that the three percent fiscal deficit target does not account for the need to vary public expenditure in line with policy requirements to adjust public expenditure contra-cyclically. In addition, linking fiscal deficit to GDP also meant that our target became susceptible to revisions in line with GDP estimates. The persisting revenue deficit combined with a fiscal deficit target has also led to complaints of squeezing of capital expenditure. We feel that there is an urgent need to review this structure. With that in mind, we would suggest that in the forthcoming year, the fiscal deficit target be maintained at a level achieved in the current year. Going ahead into the future, it may be more useful to consider that rather than pegging fiscal deficit to a percentage of GDP, which does not have a direct bearing with the ability to finance debt, a system of linking fiscal deficit to revenue collection or to the growth in revenue collection achieved in the past three years could be evolved. This may allow a measure of flexibility to deal with short term cyclical downturns in the economy. Further, this would incentivise Government both at the Centre and the States to improving efficiency of revenue collection.

9. Develop a system of "just in time" budgetary releases through extensive IT platform covering Centre, States and RBI, making UC redundant (2017-18)

The existing system of expenditure depends upon release of funds in instalments to States/implementing agencies which are in turn conditioned on the availability of a utilisation certificate for the previous release. This process implies that large sums of money are transferred through a chain of intermediaries before reaching the final utilisation authority. As a consequence, unutilised/unspent balances accumulate in different bank accounts. Delay in collecting utilisation information and submitting it holds up the process of implementation. The recent technical success in establishing the Public Financial Management System (PFMS) as well as the digitisation of State treasuries implies that we can now move to a system of fund release where money leaves the Consolidated Fund of India only when a bill is put up for payment at the implementing level after approval of competent authority. This would mean that there is no need to release money in advance and implementing organisations will be able to spend up to their authorised limits without a cumbersome process of gathering utilisation information. Such an electronic fund transfer/payment portal is feasible by with some technical strengthening of the platforms already developed. Our assessment is that this can be completed within the coming financial year, if it is taken up on priority.

As an interim measure, allow release of the first instalment in 2016-17, after adjusting for unutilised balances to ensure no parking of funds, without requiring Utilisation Certificates for the previous instalment.

10. Greater powers to Ministries to re-appropriate funds across schemes within Ministry subject to cash flow limits and restrictions on flagship schemes (2016-17)

The current financial rules require Ministries to approach the Department of Expenditure for re-appropriation above 5 crores. Most of these requests are routinely approved, however they create a time delay because of processing hurdles and a collection of large number of requests within the Department of Expenditure. There already exist guidelines on expenditure control related to cash flow limits. We feel that the practice of referring to Department of Expenditure for small re-appropriation and waiting for Parliamentary assent across narrow budget lines creates significant hurdles in implementation. It is therefore, suggested that the budget document seek approval across a grid of schemes and heads, and Ministries be given complete freedom of re-appropriation within this broad envelope, subject to broad appropriate restrictions on flagship schemes.

11. Ministries to be incentivised by providing additionalities if they generate non-tax revenue over benchmark levels (2016-17)

It is sometime not appreciated that non-tax revenue is a significant part, amounting to almost 10 to 15 per cent, of the total revenues. However, non-tax revenues have not attracted the same degree of interest in resource mobilisation compared to Tax Revenues. This needs to be addressed in a systematic manner. As a step in this direction we would suggest that Ministries are assigned benchmark targets for non-tax revenue and incentive be provided in terms of additional budget allocation if these targets are exceeded.

B. EFFECTIVE IMPLEMENTATION

The above suggestions on budget reform will address one of the major constraints of effective implementation which is, the timely availability of funds, however, while adequate fund availability is a necessary condition for effective implementation it is not sufficient. The Group offers suggestions which address some of these conditions as well.

1. Approval of schemes should include creation of all posts (including PMU at State and District levels) along with the period for which these posts would be required

In addition to financial requirements, most schemes and programs also require additional personnel for effective implementation. These are at all levels ranging from personnel in the administrative Ministry to specialised units for Project Management at the State/District level. Our experience is that at present we follow a multi-step procedure for approval. First the scheme needs financial approval thereafter a separate process is followed for getting the approval for required posts through a reference to Department of Expenditure and Cabinet (when the post is above level of Joint Secretary). This is then followed by the usual formalities of post creation and filling up, which induces different approvals be combined into a single track where both financial approval and the approval for creation of posts be done at the same time. This does not require any legislative effort and is purely an administrative/executive decision.

2. **Scheme approval should be limited to objectives, total outlay, broad guidelines, measurable outcomes with timelines, expenditure phasing and evaluation. Within these parameters, States to have freedom to formulate projects in consultation with Ministries**

The present system of approval of scheme is outlined in the guidelines for preparation of PIB/EFC proposals. They require very detailed descriptions of the scheme and expenditure across a detailed web of heads and sub-heads. This mean that schemes become highly centralised and the possibility of allowing for variations based on specific requirements in different States/ regions is reduced. We would therefore, recommend that scheme approval be limited to few key objective parameters, total outlays, broad guidelines, a clear description of measurable outcomes with timelines, expenditure phasing and a clear description of method & process of evaluation. The finer details of the scheme should be left to the States to formulate in consultation with partner Ministries. This would allow both cooperative federalism in spirit and schemes which are customised to State specificities. For this purpose, the Ministries and the State Governments should be provided necessary support on a need basis for engaging knowledge partners/ resource persons to assist in formulation of major schemes and projects.

3.(a) MIS be designed to cover reporting and monitoring of schemes using GIS and individual/institutional referencing (2017)
3. (b) MIS output to be put in public domain with provision for feedback, as a precondition to fund releases to implementing agencies (2017)

3.1 Virtually all schemes create scheme specific Management Information System (MIS) to monitor the progress of the schemes. The data generated by Government schemes and programmes have a value which goes beyond the benefits of the schemes itself. To illustrate, there are significant synergies between the operation of schemes like PMGSY, Rural Electrification and Installation of mobile towers. However, the information contained in the MIS lacks proper usability on account two considerations. First, the information is not scrutinized for inter-temporal and spatial coherence. Therefore it is necessary that it be subjected to regular validation and periodically audited. Second, the data is limited in its systemic usability on account of the lack of some key integrating factors such as geo spatial (GIS) coordinates individual and institutional referencing. We would therefore, recommend more careful attention to MIS design including appropriate ERP structures. The involvement of scientific and statistical personnel in this process would enable the MIS to be the principal data base which would not only service the scheme but also provide useable information for other agencies of the Government. Integration of the MIS with the financial monitoring portal would permit a holistic real-time monitoring of the schemes.

3.2 Finally, if MIS data is made more freely useable to all users, both within and outside the Government, it would provide transparency and efficiency in implementation. With this in view, it is recommended that this may be made as a condition towards release of funds.

4. Set up and encourage dedicated e-market portals for goods and services procured/ sold by Government/PSUs (2017-18)

4.1 Government procures annually a large number of common user items and services in small orders. A lot of time, energy and administrative cost is spent in this process. The recent development of e-commerce has shown the viability of small purchasers being able to derive benefit of scale and competition through an on-line market place. An example is e-commerce sites like Flipkart or Snapdeal. It is time that Government of India should leverage a high-end, technology driven platform to introduce greater transparency, efficiency, ease and speed in Government procurement. It is recommended that DGS&D which is a Central Purchase Organisation be asked to set-up such an e-commerce portal for Government buyers to facilitate procurement of goods and services keeping financial rules and GFR in mind. Such portal will have end-to-end integration including online payment. It should be able to address the concerns of both the buyers and suppliers through faster procurement cycle, 24X7 availability, lower cost of participation, wider and equal opportunities. A pilot project may be completed by this year end.

4.2 To illustrate efficient use of technology for disposal of Government scrap, we may direct that MSTC be authorized to use its e-Platform to auction condemned vehicles and other scrap by all Ministries & departments.

5. Inter- Ministerial review of GFR and DFPR for facilitating speedy and effective implementation (2016-17)

Our earlier discussion on budgeting, powers of re-appropriation, just in time financial release systems etc. warrant a careful reassessment of the General Financial Rules (GFR) and the Delegation of Financial Powers (DFPR) Rules. In addition the suggestion on an e-marketplace for procurement and disposal of government goods and services, suggests that there may be a need to re-visit some of the rules governing procurement. It is therefore recommended that an inter-ministerial group be set up to review these rules.

6. Create a system of internal audit

The existing system of financial administration has pre-expenditure scrutiny through the system of internal finance and the general financial rules, however, is weak in systems audit. With this in mind that there is a need to strengthen systems of internal audit to provide effective management support to the Chief Executives in different administrative Ministries and agencies by conducting systems audit. This may be done either by creating internal audit cells in each Ministry or by establishing a separate internal audit agency under the Department of Expenditure as is been done in the United Kingdom which has recently established a Government internal audit agency under the Treasury Department.

7. Creating a system for internal legal advice

In the same way, departments have complaints about the long delays in getting competent legal advice on matters which go up for litigation. It is felt that to improve the quality of our submissions before courts and tribunals and also to provide necessary legal inputs in administrative decision making, we may create an office of the Internal Legal Advisor analogous to the internal finance wing to provide necessary legal inputs to the Chief Executive of the Ministry.

C. DIRECT TAX REFORMS

The proposals on tax reforms are motivated with a desire to improve tax compliance, reduce black money and in general promote the ease of doing business. With this in mind we would like to suggest:

1. Remove exemptions provided in direct taxes for future investments while protecting existing commitments

All exemptions on Personal Income Tax and Corporate Taxes should be done away with, as a matter of policy. This would free up resources to enable declaration of a target for reduction of the tax rates. The practical way of going about it is to declare the policy, and state that unless there is a specific Cabinet approval obtained (prior to the date of effectiveness of the policy) permitting the specific exemption, all exemptions from direct taxes would cease to exist from FY 2017-18.

2. Tax Deductions to promote savings

Tax Deductions to promote savings, should in future be provided under the Exempt – Exempt – Tax (EET) form rather the complete exemption provided at present to savings under section 80(C).

3. **Eliminate both dividend distribution tax (DDT) and the exemption on Long Term Capital Gains on equity (also removing the security transactions tax).**

The effect of these would be to tax incomes at the hand of recipients at their marginal tax rates. This would be in keeping with the principle of equity. Bulk of the amounts would usually be in the highest tax brackets. This change may in the short run negatively affect stock market sentiment, but in the long run will be in line with efficiency in collection and our spirit of eliminating un-necessary tax exemptions.

4. **Reduce Corporate Taxes/ Personal taxes**

4.1 It is proposed to reduce corporate tax rates to align with global average, consistent with additional revenue mobilization from above and other such measures (2017-18). It should also be ensured that the peak personal tax rate is aligned with the peak corporate tax rate.

5. **Limited Liability Partnership firms/Partnership firms**

5.1 At present Limited Liability Partnership firms and Partnership firms (mostly small businesses) are taxed on par with corporates at highest personal tax rate. This raises costs for small businesses. We would recommend that a slab system for taxes on Limited Liability Partnership firms should be introduced so that LLPs with small turnover and profits have a lower tax rate. Further, the profits of the Partnership firms should be allowed to be taxed in the hands of partners at personal tax rates applicable to them.

D. TAX ADMINISTRATION

1. Retrospective opening of old tax returns not to be allowed except in cases of reasonable prima facie evidence of evasion.
2. Interface between taxpayer and tax authorities should be allowed only with the approval of supervisory authorities. Normal interaction should be through email and recorded video/phone interviews.
3. For small tax payers (Tax Liability less than say 5lacs), scrutiny should not be proceeded with except where the tax claim exceeds Rs. 10000 or 10% of the total tax paid, whichever is lower.
4. Improve tax administration by creating a common business identification number. This will improve and strengthen tax officials in detecting evasion, but as noted in the earlier recommendation, for the improvements in the MIS, for a unique identifier institutions. At present while AADHAR is positioned as the unique identifier for individuals there is a vacuum in so far as institutions (comprising businesses, Societies, Trusts and other non-

corporate bodies) are concerned. With this in mind, and also not duplicating existing systems following is recommend:

- ✓ Making PAN mandatory for all businesses and entities
- ✓ Mandate PAN to serve as unique business identity number in all Central Government Databases.

5. Reducing incorrect taxation orders through administrative action

It has also been noted and pointed out to the group in many interactions that tax administration systems should incorporate principles of efficient decision making in its structure of human resource management. With this in mind, it is suggested that officials who have their orders repeatedly over-turned by higher authorities including courts be assessed administratively for necessary corrective action.