Public Sector Wastage - Issues and Challenges

Sunil S. Bhandare

FORUM
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> *"Free Enterprise was born with man and shall survive as long as man survives".*
>
> - A. **D. Shroff**
> Founder-President
> Forum of Free Enterprise

SHAILESH KAPADIA

(24-12-1949 – 19-10-1988)

Late Mr. Shailesh Kapadia, FCA, was a Chartered Accountant by profession and was a partner of M/s G.M. Kapadia & Co. and M/s Kapadia Associates, Chartered Accountants, Mumbai.

Shailesh qualified as a Chartered Accountant in **1974** after completing his Articles with M/s Dalal & Shah and M/s G.M. Kapadia & Co., Chartered Accountants, Mumbai. Shailesh had done his schooling at Scindia School, Gwalior and he graduated in Commerce from the Sydenham College of Commerce & Economics, Mumbai, in **1970.**

Shailesh enjoyed the confidence of clients, colleagues and friends. He had a charming personality and was able to achieve almost every task allotted to him. In his short but dynamic professional career, spanning over fourteen years, Shailesh held important positions in various professional and public institutions.

Shailesh's leadership qualities came to the fore when he was the President of the Bombay Chartered Accountants' Society in the year **1982-83.** During his tenure he successfully organized the Third Regional Conference at Mumbai.

Shailesh was member, Institute of Fiscal Studies, U.K.; member of the Law Committee and Vice-chairman of the Direct Taxation Committee, Indian Merchants' Chamber. He was also a Director of several public companies in India and Trustee of various public Charitable Trusts.

He regularly contributed papers on diverse subjects of professional interest at refresher courses, seminars and conferences organised by professional bodies.

Introduction

In recent years growth and well-being achieved by citizens is measured largely in terms of the quantum of outlays, despite great stress laid by the Finance Minister in his budget speeches on laying emphasis on outcomes. Hence the overall productivity of capital in the economy has been declining with populism and inclusive growth holding sway. Sound economic planning and rationale has been swamped by political considerations.

Mr. Sunil Bhandare's essay has rightly placed the torchlight on public sector wastage and its causes also suggesting very pragmatic measures to mitigate and reduce these. He rightly pinpoints good governance for combating corruption and public sector wastage to pave the path for rejuvenating the economy and ensuring sustained development. Wastage in simple terms as defined by the author encompasses depletion, drain and leakage of public resources. These arise out of misuse of public spending. Cost and time overruns in public sector projects have become a rule rather than an exception. This arises out of inadequate planning, creation of excess capacities, resulting in under utilization and often adoption of outdated technologies. These deficiencies have given rise to lot of corruption and gold plating of project costs. The problem is exacerbated by granting of mindless misdirected subsidies, often untargeted, loan waivers and write-offs to Public Sector Undertaking (PSUs) and persistent budget support to loss making PSUs irrespective of their non-viability.

Mr. Bhandare rightly maintains that many projects which go under the heading of 'public expenditure' are a powerful instrument for ensuring equity and social justice through redistribution of income. It is necessary because many of the items covered under public service and goods do not attract private investment. However, the efficacy of this expenditure and whether it reaches the intended under-privileged sections is very casually monitored, leaving room for massive leakages, ultimately resulting in larger revenue deficits. Hence the imperative need is to assess public expenditure in terms of its outcomes and not merely by outlays. This is so critical as India's resource raising capacities are limited, given its very low tax GDP ratio and the lack of political convergence in introducing salutary tax measures like the goods and service tax.

India is also beset with the problem of classification of expenditure as Plan/Non-Plan. This creates the erroneous impression that non-plan expenditure is non-essential, which is not so as a large portion of it is utilized for maintenance of assets already created.

The re-engineering brought about in the fiscal arena through enactment of Fiscal Responsibility and Public Management Act 2003 to bring about reduction in fiscal deficits and control Debt/GDP ratio has been a very welcome step. However, the implementation of this Act has been halting, and has fallen a prey to political exigencies.

The author's conclusions are telling. He ascribes the present economic scenario as dismal. He recommends aggressive measures to combat public sector wastage and inefficiencies. The government must seriously pay heed to the wise old adage "the business of government is governance and not business". This would involve government vacating economic activities where it is not capable of managing effectively and profitably. It would also call for strengthening the Institutions of governance, granting greater autonomy to PSUs and public bodies and strict enforcement of law. The FRBM must be enforced with vigor.

Fortunately while the government has been a laggard in enforcing greater discipline in areas within its legitimate domain, the other stakeholders in governance - civil society, social organizations and the media, have expanded and have become more vociferous and demanding. This should augur well for stemming wastage in the public sector.

This is a very well researched and documented paper and deserves careful study and reflection of all those genuinely interested in improving the present awfully poor standard of public governance.

Minoo R. Shroff
President
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Public Sector Wastage - Issues and Challenges

by

Sunil S. Bhandare*

Part I: Setting the Perspective

"The tragedy of India is the tragedy of waste – waste of national time, energy and manpower. Tens of millions of man-hours, crammed with intelligence and knowledge – of tax gatherers, tax payers and tax advisers – are squandered every year in grappling with the torrential spate of mindless amendments. The feverish activity achieves no more than a fever". [Late *Mr. N.* A. Palkhivala in Preface to the eighth edition of his magnum opus on The Income-Tax Act, 1961, published in 1990]. What was then said in the context of Income-Tax

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legislation and administration has been valid, and is perhaps more valid even today in practically all areas of economic and fiscal management of our country. Literally billions of rupees worth of national output, national resources, national time, energy and manpower are lost to our economy every year. And all these in the pursuit of "public expenditure-driven" developmental planning and projects; social welfare programs; and goals of social equity, justice and inclusive development!

In the current context of Indian economy, and especially against the backdrop of sharp deceleration of economic growth, virtual industrial stagnation, declining savings and investment rates, external imbalances accompanied by recent rapid depreciation of the Indian rupee, loss of confidence of both consumers and investors, growing pressures on the banking sector of non-performing assets, and more worrisome stresses and strains on fiscal management, the time is most opportune for us to reflect upon the issues and challenges of public sector wastage in our country.

Indian economy is truly at the critical cross-roads, and is besieged with multiple challenges. its dream run of growth story has been stalled. The path of economic reforms is stumbling. There is a sense of disquiet given the over-zealous advocacy of some extreme form of populism and the prospects of some sharp drift towards leftist orientation in the current discourse in our political economy. Hence, it is imperative to combat the prevailing predicament of doom and gloom through vigorous pursuit of long-pending economic reforms, in which tackling the menace of public sector wastage must assume centrality of our focus. Indeed, we believe that one of the key messages from the remarkable emergence of AAP on the political firmament is very clear: ***Good governance, which combats corruption and public sector wastage, can only pave the way for the restoration of growth momentum of our country as well as for its sustainable development in the long-run.***

But what precisely is the meaning and significance of the word "wastage"? Roget's Thesaurus provides many subtle nuances of its meaning, encompassing within its fold the issues of – depletion, dissipation, decrement, drain, impoverishment, leakage, etc. In a sense, public sector wastage can be seen to cover all such possible outcomes due to misuse or inefficient use of valuable fiscal resources. ***Where does such public sector wastage manifest in the Indian context?*** Obviously, it could take various forms. Illustratively,

9 First, at the macro fiscal level, through misuse or leakages of public spending, irrespective of whether such expenditure allocations are classified under developmental and non-developmental heads; or under capital and revenue accounts; or under plan and nan-plan expenditure format. ***All forms of government***

expenditures are prone to leakages, misappropriation, creation of excess .capacities, under-utilization of valuable capital investment, wrongful production planning, deployment/ application of wrong technology, etc.

- Second, once again at the macro fiscal level, revenue deficit is a most significant indicator of public sector wastage. It is revealed from excess of revenue expenditure over revenue receipts (both tax and non-tax), which ultimately leads to increase in public borrowings on year-on-year basis. Cumulatively, these cause expansion of governments' liabilities without corresponding increases in their assets.
- Third, typical cost and time over-runs of public sector projects – and such cases are galore in the Indian context.
- Fourth, various forms of direct and indirect subsidies – some of which are legitimate and justifiable, but most create opportunities for their misuse and create entrenched vested interests for their eternal continuation.
- Fifth, granting of loan waivers and loan write-offs to public sector undertakings (PSUs) either from the governments' budgets or by imposing their burden on banks and financial institutions.
- Sixth, the persistent budgetary support to loss-making PSUs, most of which is often utilized for

payment of wages and salaries or interest over-dues of banks and other financial institutions/ creditors.

- Last, but not least important, it manifests in virtually forcing high profit-making and cash-rich PSUs to declare and pay to the exchequer disproportionately high dividends from their profits with a view to meeting budgetary revenue gaps. Often times, these practices deprive such enterprises the alternative opportunities of using their reserves and surpluses into genuinely productive and profitable expansion, diversification and modernization programs.

It is commonly known that in India, a large portion of public expenditure is lost to a maze of red tape, fraud, waste, and corruption. Often times, many high-ranking government officials have been candid enough to admit such phenomenon. Indeed, what has been oft-quoted is a well-scripted observation coming from no less a person than the former Prime Minister of India, late Mr. Rajiv Gandhi, who famously remarked that for every one rupee spent on poverty alleviation programs in India only 17 paise (or 17% of the total) reached the intended beneficiary. Before turning to more such issues of public sector wastage, let us briefly reflect on the economic imperatives of growth in public spending or budgetary expenditure.

Rationale for the Growth of Public Spending

Over the past many decades, there has been massive theoretical and analytical research work on objectives and importance of government expenditure – both in Indian and international context. The underlying philosophy and strategy suggests that ***public spending sub-serves many well-defined economic and social goals characterised as provision of public goods and services*** – like primary education and health; social welfare; building of physical infrastructure – for example, from construction of roads and bridges to water supply, rural electrification, public transport, public housing, etc; maintenance of external and internal security – defence and law and order; and running of key institutions of governance, namely, legislative, executive, administration and bureaucracy, and judiciary. Public expenditure can also become a powerful instrument for ensuring equity and social justice through redistribution of income by way of subsidies, cash transfers, guaranteed employment programs, etc. Obviously, most such activities of providing public goods and services can not attract private funding and investment. However, a predominant part of these are financed through tax and non-tax revenues as well as other forms of resource-raising efforts from users of such public goods and services.

Thus, in a broader socio-economic context, one easily recognises the importance of public expenditure as means of serving three principal goals, namely, provision of basic entitlements to the citizens of the country, empowerment of their societal status, and enhancement in their living standards. ***Indeed, under this construct, public expenditure often times becomes justifiable even if it "may not be 100% efficient in avoiding the avoidable deadweight loss"*.*** It is perceived to be reaching out not only to those at the bottom of the pyramid or those sections of the society who have hitherto been neglected and deprived of basic means of livelihood and good quality of human existence, but also in balancing and sustaining several well-defined parameters of socio-economic development and good governance. In case of less developed as well as emerging and developing economies (EMDEs), the government's role in the initial years or even during many decades of developmental process has to be directed towards promotion of infrastructure development – both physical and social – and creation of conditions that are conducive for attracting or "crowding-in" private initiative, enterprise and investment. Thus, all such functional aspects of the governmental expenditure are very legitimate and have to be performed.

But, at the same time, efficient use of public resources and essential concerns of fiscal discipline can not at all be ignored and sacrificed. Avoiding public sector wastage must become an integral part of good fiscal governance. All governments seek to collect revenues and raise borrowings, and are expected to allocate and use such resources responsively, efficiently and effectively. *Unfortunately, the growing fiscal burden as a result of expansion of the state economy and widespread state interventions are increasingly becoming a major stumbling block in sustainable economic development and fulfilment of social welfare objectives.*

Indeed, as an aftermath global financial and economic crisis of 2008, most countries have virtually been forced into fiscal expansion by granting tax cuts **and/or** increasing public spending to combat the then widely perceived apprehensions of Great Depression, which eventually has turned out to be Great Recession! **Thus,** most advanced economies suffered negative growth rates in 200912010, massive unemployment and social tensions. But thanks to fiscal stimulus on the one hand, and unprecedented monetary (quantitative) easing on the other, the global economy, and especially the worst affected advanced countries, could overcome grave prospects of a prolonged economic drift. Most of them have now been able to usher in gradual, but still a hesitant process of economic recovery. *The point that once again needs **to** be stressed is that public expenditure does seek to achieve multiple developmental*

and social objectives. It is also a powerful tool of counter-cyclical economic policies as well as for bringing about structural transformation in any economy.

International Comparison of Public Expenditure

Against this backdrop, let us briefly reflect on dimensions of governmental expenditure in **India** in comparison with some of the advanced countries and EMDEs. As mentioned earlier, across all the countries of the world, the governmental functions tend to be almost similar, but with varying degrees of importance and intensities in their composition. *In most of the advanced countries, social welfare benefits (including health) account for very significant and rising share of public expenditure, while in most of the less developed countries and **EMDEs,** infrastructure development account for a larger share of public expenditure.*

For example, in European countries, government **functions** cover a wide spectrum of activities like – culture and education, health, social protection, general public services, defence, order and safety, environmental protection and housing. According to the EUROSTAT data released in 2011 by the European Commission, general government expenditure in EU 27 countries amounted to 49.1% of GDP, and of which, more than half was devoted to functions of 'social protection' and 'health'.

Like-wise, from the data available in 2011 Index of Economic Freedom, the range of government spending to GDP ranges from 37% in Japan and 38.9% in the USA to as high as 43.7% in Germany, 47.3% in UK and 56% in France. All these countries have been struggling over the last few years to manage their large fiscal deficits and mounting public debt. Amongst BRICS economies, the ratio of government expenditure to GDP ranges from the low of 20.8% in China to 34.1% in Russia and as high as 41% in Brazil. India and South Africa share almost the same status with governmental expenditure representing around 27.2% of GDP.

Our own data from official government sources indicates that combined expenditure of the Centre and States − whether classified as developmental and non-developmental; or revenue and capital expenditure; or plan and non-plan expenditure − in the post-reforms period [1991-92 to 2012-13] increased at an average annual rate of 14.2%. ***The pace of growth of such government expenditure has been relatively faster since 2008-09 at an annual average rate of about 17% largely under the impetus of fiscal stimulus − a post- global economic crisis phenomenon!*** But even more importantly, there has been a rapid shift in thrust towards social sector spending. Thus, over the post-reforms period, the ratio of combined expenditure of Centre and States, after showing some retreat in

the first decade of reforms, has risen from 26% in 1990-91 to over 28% in 2012-13.

Centrality of Quality of Public Expenditure

Evidently, this very broad international comparative picture of ratio government expenditure to GDP of respective countries suggests that India's ratio is relatively low. But by no means, this can be suggestive that governments in India (Centre and States) are less intrusive/less interventionists. Neither does it indicate efficient or effective system of fiscal governance in our country. ***While making objective assessment of public expenditure, it is not just the quantitative dimensions that are important, but what is far more crucial, are its qualitative aspects and outlay-outcome results!*** In India, like in almost all other economies, the size of government spending is predominantly determined by resource raising potential and capacity from both tax and non-tax avenues. Thus, tax to GDP ratio in India is relatively low due to many faultlines in the tax structure and administration, including large part of the economy virtually remaining outside the purview of any form of direct taxes, whether personal or corporate income taxes. Even the system of indirect taxes like Customs, Service Tax, CENVAT, States VAT, etc. is besieged with serious loopholes and leakages. In short, thanks to widespread practices sf tax avoidance, tax evasion and corruption made possible mostly by inadequacies of the tax system per se and fault-lines in effective tax administration and management, there are inherent limitations of fiscal space in India.

The problem of limited fiscal space becomes even more compounded by the wastage of public spending manifesting in various forms of leakages, including widespread prevalence of inefficient and loss-making public sector undertakings (PSUs). Besides, there is a third-layer of our federal structure, namely, of village panchayats, urban local bodies, the municipalities, etc. Together, this third-layer too accounts for substantial resource-raising and spending activities. There is virtually no comprehensive data/estimate of their composite revenues and expenditures.

Hence, the macro picture of extent of public sector wastage remains an enigma wrapped in mystery. But there is sufficient anecdotal and circumstantial evidence of huge waste of public resources at all levels of governments. This predicament is truly hampering the growth potential of the economy. A ***vicious phenomenon is, thus, in operation,*** depriving our economy the advantage of fuller growth potential, and consequent loss of buoyancy in tax and non-tax revenues! Hence, we strongly reiterate that efficient expenditure policy based on principles of avoidance of public sector wastage must necessarily be an integral part of our strategy for reviving and accelerating India's economic growth story and building up a truly equitable society. The key message is that

"the business of government is governance and not business': This is what both late Mr. Nani Palkhivala and Dr. B. R. Shenoy have so passionately preached and stood for all through their life.

Part II: Composition and Structure of Public Expenditure in India

Let us now turn our focus on broad-based composition and structure of aggregate public expenditure in India -- Central and State Governments together. There is a three-fold classification of governments' budgetary spending: first, revenue and capital expenditure; second, plan and non-plan expenditure; and third, developmental and non-developmental expenditure. The last two expenditure classifications also incorporate both revenue and capital expenditures. Such divergent classification of government expenditure is perhaps unique to India, and is in vogue for past many decades. It often creates enormous confusion while assessing overall economic and sectoral impact of governmental spending on various schemes and projects on the economy. In this context, it is relevant to quote some significant observations from the Report of Dr. Rangarajan Committee on Efficient Management of Public Expenditure submitted to the Planning Commission in July 2011. It states thus, "Due to the complex nature of Government, the policy regarding what should get classified as plan expenditure and what should get classified as Non-Plan expenditure has been losing clarity. Besides, a notion has widely gained ground among the policy makers and officials across all levels that plan expenditure is good and Non- Plan is bad. This bias in favour of Plan expenditure and against Non-Plan expenditure has led to a situation in which essential Non-Plan expenditure like maintenance of assets is neglected. This has also led to a motivation for showing higher plan expenditure and higher plan sizes both at Central and State levels. Further, several factors such as shift of plan focus from capital to revenue expenditure and the process of transferring expenditure of old schemes to Non-Plan at the end of each Five Year Plan mean that correspondence cannot be drawn between plan and development expenditure."

It further states that "The Plan/Non-Plan bifurcation of expenditure has contributed to a fragmented view of resource allocation to various programmes1 schemes. With fragmented view, it is difficult not only to ascertain cost of delivering a service but also to link outlays to outcomes. Outcomes and outputs of programmes depend on total expenditure, Plan and Non-Plan put together and not merely on Plan expenditure which constitutes about 30% of the total expenditure only. To conclude, Plan and Non-Plan distinction in the budget is neither able to provide

a satisfactory classification of developmental and non-developmental dimensions of Government expenditure nor an appropriate budgetary framework. It has, therefore, become dysfunctional. The Committee, therefore, recommends that Plan and Non-Plan distinction in the budget should be removed. At the Central Government level, Planning Commission may be responsible, for the sake of convenience and domain knowledge, for guiding the overall development priorities of the Government, setting of outcome targets and review of performance of Ministries/Departments. Ministry of Finance may be responsible for guiding the fiscal policy, preparation of budget and financial decisions. Planning Commission may be responsible for consolidation of the Five Year Plan covering all Services based on the inputs from the Ministry of Finance. The annual budgeting process may need to be revised to facilitate output and outcome-based budgeting within a multi-year framework."

In substance, what is said herein is illustrative of so many fault-lines prevailing in the existing classification of governmental expenditure, and therefore, the enormous difficulties faced in objective assessment of economic outcome of government spending and the dimensions of public sector wastage. The Committee's Report contains some far reaching recommendations for reforming the classification of the expenditure budgets, and we suggest that this should be seriously pursued by the Government.

Although there are some fundamental issues about definitional aspects of developmental and non-developmental expenditure, an analysis of expenditure, based on this classification, would be useful in judging the quality of government spending. ***The official definition of developmental expenditure*** refers to all items of expenditure that promote economic development and social welfare. These are generally supposed to enlarge and improve the physical resources of the country, enhance knowledge, skills and productivity sf the people and ensure efficiency of the system. Such expenditure broadly includes all major socio-economic heads shown in the budget document. But, it excludes some non-plan expenditure like pension, social security, etc. Developmental expenditure has three components: (a) revenue developmental expenditure; (b) capital developmental expenditure; and (c) developmental loans and advances. The official definition further suggests that expenditures other than developmental expenditure, except loans and advances given by the Government, constitute non-developmental expenditure.

Both the quantity and the quality of public expenditure has always been an important issue, especially while analysing the impact of public expenditure on overall economic development. ***The quantity parameters can indicate the scope for wastage,***

while quality norms clearly identify the wastage. In judging quality of expenditure, experience of many developed and EMDEs indicate the use of a wide variety of measures such as (a) priorifisation and capping of certain public expenditure allocations; and (b) greater transparency and accountability in their actual spending.

Incidentally, on the lines of many other countries, which embarked on a massive effort in reengineering government expenditure, the Government of India introduced the ***Fiscal Responsibility Budget Management (FRBM) Act, 2083*** both to check the quantitative dimensions of public expenditure and to ensure its quality. This legislation, among other things, seeks to ensure long-term economic and fiscal stability, and for which, it prescribes certain norms of good fiscal governance such as (a) progressive reduction in both revenue and fiscal deficit to GDP ratios; (b) prudential limit on debt to GDP ratio consistent with fiscal sustainability; (c) greater transparency in fiscal operations; and so on.

It will be observed from the Table I below that in the aggregate expenditure of Central and State Governments, the share of developmental expenditure has increased steadily after the enactment of FRBM Act. ***Prior*** to ***this legislation, the share of non-developmental expenditure was continuously increasing; 2004-05 was a watershed year after which the share of developmental expenditure***

started rising, with corresponding decline in the share of non-developmental expenditure. Thus, the share of **developmental** expenditure in the first decade of reforms had declined from 58.8% in 1991-92 to 50.9% in 2001-02, but recovered well since then to 59.5% in 2011-12 and retreated a bit 58.1% in 2012-13.

Table I: Total Expenditure of Centre & States and Its Composition

(Rupees Billion)	Total Expenditure	Of Which		% Share	
		Developmental	Non-Developmental	Developmental	Non-Developmenal
1991-92	1859	1094	765	58.8	41.2
2001-02	6530	3322	3208	50.9	49.1
2010-11	21451	12677	8774	59.1	40.9
2011-12	25188	14978	10210	59.5	40.5
2012-13	28359	16469	11890	58.1	41.9
% CAGR (1991-2001)	13.4	11.7	15.4	-	-
% CAGR (2001-2012)	14.3	15.7	12.6	-	-
% CAGR (1991-2012)	13.9	13.8	14.0		

Notes:

(1) Non-developmental expenditure includes a small component of "others" of States.

(2) **CAGR** refers to compound annual growth rate during the period.

(3) Data for 2011-12 are revised estimates and data far 2012-13 are budget estimates. Hence, there would be some variations in the final actual figures, when available

Source: Handbook of Statistics of Indian Economy, 2012-13.

But this relative increase *in* ratio of developmental expenditure per se is no indication of any qualitative *gains/* improvement in the management and outcome of public *expenditure* in recent times. It is imperative in this context to analyse also the **sectoral** pattern of both **non-developmental** and developmental expenditure, as shown below in Tables **II** and Table **III,** respectively:

Table II: Major Components of Aggregate Non-Developmental Expenditure of Centre and States Combined (% share of total)

(Rupees Billion)	1990-91	2000-01	2011-12	2012-13
Total Non-Developmental Expenditure	692	2,988	11,264	13,265
1. Defence Services	22.3	16.6	15.2	14.6
2. Interest Payments	36.1	41.1	36.3	35.4
3. Food Subsidy	3.6	4.2	6.8	6.0
4. Administrative Services*	25.5	28.2	31.9	31.0
5. Social Security & Welfare	**3.5**	**2.8**	**2.6**	**2.6**
6. All Others**"	9.0	7.1	7.2	10.4

* Includes pension & other retirement benefits, tax collection charges, organs of state

** Includes border roads, relief on account of natural calamities, technical and economic cooperation with other countries, currency, coinage & mint, compensation & assignment to local bodies, etc.

Source: Indian Public Finance Statistics 2012-13, Ministry of Finance, GOI. July 2013.

Note: Given two different data sources in Table **I** and Tables **II** & III, some discrepancies in figures are inevitable.

Non-developmental expenditure continues to be dominated by interest payments and administrative ***expenditure,*** the share of latter has been rising progressively due largely to payments of salaries and pensions of huge bureaucratic machinery of the governments. Despite the voluminous reports and recommendations of the Expenditure Reforms Commission (2001, headed by K. P. Geethakrishnan) and the second Administrative Reforms Commission (2005, headed by Veerappa Moily), *no serious efforts have been made* ***towards*** *downsizing the bureaucracy-, administering the projects and programs, and reforming the overall administrative structure in the country.* The share of revenue expenditure in the overall non-developmental revenue expenditure is also dominated by defence spending and rising food subsidy bill. The inefficiencies and leakages in the public distribution system (PDS) are far too well-known and have also been adequately documented in various official and **non-official** reports. Over the past many years, there are also sufficient instances of corruption and leakages in various defence deals. *Even* 10% *saving in the over-all non-developmental expenditure* **-** *both at Central and States governments levels* **-** *by plugging such leakages and wastages can generate enough financial resources* ***to*** *fund our languishing, but more productive physical and social infrastructure development programs.*

Further, this would reduce the pressures of public borrowings and public indebtedness and help in reducing the high interest rate structure in the economy.

Table **III:** *Major Components of Aggregate Developmental Expenditure of Centre & States Combined* (*% share of the total)*

(Rupees Billion)	1990-91	2000-01	2011-12	2012-13
Total Developmental Expenditure	**740**	**2,361**	**12,854**	**14,561**
1. Agriculture & Allied Services	**15.8**	**13.1**	**12.8**	**13.0**
2. **Industry 8 Minerals**	5.2	2.9	7.7	5.5
3. Power & Irrigation*	13.7	14.3	10.3	10.2
4. **Transport & Communications**	**6.2**	10.4	9.7	10.2
5. Railways	2.2	1.4	1.6	1.6
6. Social & **Communi Services**	41.9	48.3	46.7	48.0
7. Fertilizer Subsidy	5.9	5.8	5.3	4.2
7. All Others**	9.1	3.8	5.9	7.3

* **Includes flood control ** Includes posts & telecommunications, general services like foreign trade and export promotion, public works, etc.**

Source: Indian Public Finance Statistics 2012-13, Ministry of Finance, GOI, July *2013*

Evidently, social and community services – under the massive thrust on "inclusive" development strategy of the governments **-** have progressively taken almost half of the share of developmental expenditure. ***The limited fiscal space is, thus, being pre-empted by social sector spending and the intensity of public sector wastage is believed to be generally more in this area.*** Once again, a comprehensive report of the Committee constituted by the Planning Commission on Restructuring of Centrally Sponsored Schemes [(CSS) 2011, headed by B. K. Chaturvedi], among many other things, points out that "the monitoring by Ministries and independent evaluation of schemes is generally poor in CSS due to gaps in design of scheme, lack of ownership amongst States. No emphasis is being laid on outcomes or impact of these through independent assessment1 evaluation". In substance, even in the so-called developmental expenditure, there are avenues of serious public sector wastage.

Part III: Wastage in Public Sector Enterprises & Some Anecdotal Experiences

Let us then turn to issues of public sector wastage manifesting in the working of Central Public Sector Enterprises (CPSEs), as also in some illustrative cases of public sector development projects. Past experiences have shown that many CPSEs and other development projects, having laudable objectives, have failed to deliver the results. Most of such failures are attributable to (a) fault-lines in assumptions about some crucial technical and

non-technical parameters; (b) imperfect knowledge about the local situation; (c) time and resource constraints; (d) inadequacies in design and implementation; and so on. Time and cost overruns have, indeed, become the hallmark of many public sector infrastructure and investment projects. Likewise, the benefits intended to be delivered to the people through development programmes in social sectors have not fully reached the beneficiaries due to the weaknesses in administrative planning and delivery mechanism.

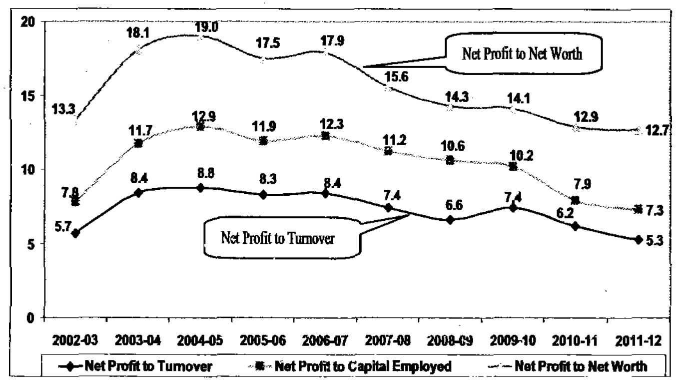
Way back in 1971, Dr. B. R. Shenoy in his very perceptive article titled "Public Sector Wastage" [published in Bombay Pradesh Congress Souvenir: January 1971] unveiled the "picture of waste" of government undertakings, which are perfectly valid even to-day. What were the manifestations of public sector wastage? To quote some of the meaningful descriptions of such wastage from his observations then: (a) idle production capacities; (b) unconscionable wastage of materials and accessories; (c) incredible over-staffing; (d) lack of cost consciousness; (e) gross neglect of maintenance of plant and equipment; (f) high cost and low quality; and (g) pressures by politicians and interference by the Ministries. All these features of inadequacies in CPSEs' management in India seem to be of eternal relevance!

A brief profiling of CPSEs, based on available official data of such enterprises in 2012-13, would enable us to evaluate what could be the opportunities for unlocking their true potential! There are 225 CPSEs, of which 161 are profit-making and the balance 63 are loss-Making. The contribution of all profit-making CPSEs by way of profits is Rs.1251 billion, while loss-making CPSEs together knockoff Rs.276 billion through their losses. In addition, oil companies suffer hugely from the administered pricing policy of some of the petroleum products, and as a consequence recorded under-recoveries of as much as Rs.550 billion in 2012-13. A huge amount of capital is employed in all these enterprises – over Rs.13280 billion, while their gross turnover amounts to Rs.18419 billion. Thanks to the disinvestment of some of the CPSEs in the post-reforms period, there are 44 listed enterprises whose market capitalization as of March 31, 2012 was about Rs.12532 billion. There must have been some sizeable increase in their market capitalisation thanks to the recovery in stock market sentiments since then.

The aggregative performance of Central PSEs often conceals many problem areas such as lack of transparency, clarity and detailing on magnitudes of (a) losses of loss-making enterprises; (b) under-recoveries of oil producing1 marketing companies; and (c) Central Government's constant budgetary support to loss-making companies to

enable them to even pay salaries and wages to its employees and cover their interest obligations on loans as well as to their vendors. The private corporate sector, especially well-managed profit-making companies, on an average, shows better profitability performance, while perennially loss-making companies eventually go under liquidation under the compulsive pressures of market driven economy. A ***crude calculation would suggest that every one percentage point improvement in return on capital employed of CPSEs could generate additional profits of Rs.132 billion, and every one percentage point gain in profit margin ratio, can yield extra Rs.184 billion.***

The following chart above reveals the performance of Central PSEs based on key profitability ratios. What is important to note is that the best performing years for them were from 2003-04 to 2006-07 –



which incidentally happened to be the dream run of Indian growth story. That was perhaps the most opportune time to maximise gains by undertaking vigorous disinvestment and strategic privatisation, but it was lost because such strategy was not found to be politically expedient, although economically sound. Since then, however, there has been a rapid slide in their profitability performance, and the recovery process is likely to be fairly long-drawn.

Development Projects – Cost and Time Overruns

The perennial problems of time and cost overruns offer yet another manifestation of public sector wastage in our country. Thus, according to 2011-12 annual report of MOSPI, Govt. of India, the average cost overruns were 20% in respect of 584 major projects of 15 different Ministries – the original project cost was Rs.6908 billion, but the anticipated works out to Rs.8288 billion; and the actual may turn out to be still higher. And time overruns of these projects vary from minimum of 2 months to maximum of 213 months; the median seems to be closer to 50 to 60 months.

Various other anecdotal evidences of public sector wastage, illustratively, are:

- As on March 31, 2012, 555 projects (worth Rs.1.50 billion and above) were on-going, out of which 179 projects reported cost overruns

of around Rs.1230 billion [based on Minister's reply in Rajya Sabha];

- The CPSUs are engaged in executing over 560 major projects costing above Rs 1.50 billion in 14 different infrastructure sectors as of Sept 2013. The total original cost of these projects is more than Rs.7900 billion and 48% of these suffer substantial delays and cost overruns;
- In Maharashtra over Rs.420 billion were spent on 426 irrigation projects and most of these still remain incomplete as of March 2012. In case of 242 projects, the initial cost of Rs.72.2 billion, has risen to as much as Rs.338.32 billion.
- In case of 29 km long Udhampuir-Srinagar-Baramulla railway line the original cost of Rs.30.8 billion in 1999-2000 has escalated to over Rs.195 billion.

All these and many more such cases are attributable to:

1. Poor project formulation due to inadequate field investigation, lack of adequate data, inadequate analysis of environmental and rehabilitation implications, changes in prices and exchange rate regimes, etc.
2. Delays in clearance from various regulatory agencies in land acquisition and in procurement of materials. Such delays are primarily due to

poor coordination and project planning, as these problems are not explicitly considered or taken into account at the planning stage.

3. Changes in design or scope of projects midway through execution.
4. Inability of the project management to take prompt decisions on various aspects of these projects even when the objective circumstances warrant such decisions.
5. Management problems such as personnel, labour and contractor disputes, mis match of equipment, etc.
6. Inadequate and untimely release of funds.
7. Unforeseeable factors such as adverse geo-mining conditions and natural calamities.

Part IV: Concluding Observations

In summing up, the end result of all the issues discussed above is a huge public sector wastage and consequent deprivation of valuable investible resources for further economic and social development of our country. Who suffers in the ultimate analysis? Indeed, the people of this country – the common citizens – who are dispossessed of their opportunities of rightful entitlement and empowerment! Who are the beneficiaries – surely, the adversarial stakeholders – be they ministers,

bureaucrats, promoters, crony capitalists, intermediaries or even the technocrat professionals!

In current dismal economic scenario of our economy, combating the challenges of public sector wastage should assume topmost priority, irrespective of which single political party [most unlikely!] or coalition of parties [almost certain!] form the next government after the general elections scheduled to be held in May 2014. ***At a time when its economy is confronted with challenges of growth stagnation, India certainly does not have the luxury of allowing perpetuation of drain, depletion, dissipation and leakages of its vital financial and manpower resources, energies and efforts.***

What is the way forward? To reiterate, the key message from our discussion so far is that "the business of government is governance and not business". To translate this message into action, the governments (both Central and states) must ***recognise the centrality of governance in general and fiscal governance in particular.*** It is imperative to reinvent and strengthen the institutions of governance such as (a) constitutional institutions [Legislative, Executive, Judiciary, CAG, etc]; (b) regulatory institutions [financial – RBI, SEBI, IRDA, etc.; and non-financial - CERC, TRAI, CCI, APMC, etc]; and (c) other institutions that would promote more effective Centre-States relations – National Development Council, Inter-States Council, etc.

As an integral part of this strategy, there is an ***urgency of reviving and strengthening Fiscal Responsibility and Budget Management (FRBM) Act.*** Apart from commitments to fiscal targets – budget deficits, public borrowings and public debt, efforts must be made to strategize (a) the framework of Outlay-Outcome Budget – including targeting subsidies and welfare schemes; (b) Performance Monitoring and Evaluation System; (c) reforms in the classification of budgetary expenditure; and (d) creation of autonomous Fiscal Council – for review and monitoring implementation of FRBM and for sustained dialogue on fiscal policy. Equally importantly, for conserving and using efficiently existing budgetary resources, administrative reforms at all layers and levels of our federal system of governance become critical. The composition of expenditure must shift decisively in favour of productive capital and developmental expenditure, whose positive impact multiplier is found to be significantly higher than revenue and non-developmental expenditure. Finally, the policy of disinvestment and privatization requires a fresh revalidation and reorientation based on the experience of the last over two decades. The objective should be not just mobilising resources for meeting funding gaps of the budgets, but usher in

the new ethos of highly competitive, efficient and financially viable economic system and structures.

Let me conclude by reemphasising our thrust on ***centrality of governance*** by quoting from the speech of Mr. Vinod Rai, former CAG, at Harvard Kennedy School in the US *"Good governance, according to the United Nations, is when its authority and institutions are accountable, effective and* ***efficient,*** *transparent, responsive, equitable and inclusive and follow the rule of law. In the present age, governance has assumed such critical proportions that it appears too important to be* ***left*** *only to the government. The stakeholders in governance have expanded beyond the executive, legislature and judiciary to civil society, social organisations, media and the public. Apart from the base expanding, each new stakeholder has become very vociferous and demanding." We believe that the voice of each new stakeholder must become even more vociferous and demanding as we move forward!*

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"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

- Eugene *Black*
Former President,
World Bank

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