UTTAR PRADESH
REFORMING THE BUDGETARY SYSTEM

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Preface

This study has been undertaken by the National Institute of Public Finance and Policy at the instance of the Resource and Expenditure Commission of Uttar Pradesh, Lucknow.

The study team consists of D. K. Srivastava, C. Bhujanga Rao, and Manish Gupta. Opinions and analyses here are those of the authors. The members of the Governing Body of the National Institute of Public Finance and Policy are in no way responsible for these.

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2. In India, the responsibility for preparing the budget devolves on the executive. The budget estimates are prepared for the financial year commencing on 1st April and ending on 31st March of the ensuing year. The exercise of preparing the estimates of revenue and expenditure begins some eight months in advance with the issue of the budget circular by the budget division of the Finance department.

3. There are four successive stages of a budget *viz*., Government Stage, Legislative Stage, Implementation Stage, and Stage of Ex-Post Control. These stages may alternatively be called as budget formulation, approval, implementation, and follow-up stages.

4. A coherent approach to budget reforms will involve aggregate and binding fiscal targets; incentive for improving allocation and utilisation of resources; autonomy of departments and decentralisation of responsibilities; and outcome budgeting.

Designing an Annual Budget: Issues of Consistency with Macro Considerations and Medium Term Targets

5. The total expenditure of the Government should be aligned to availability of resources over the medium term within the context of sustainable fiscal deficits. Expenditure should be appropriately allocated to match policy priorities, so as to produce the intended results at minimum cost. Affordability must influence policy making and planning at the point when the decision is made. A medium-term approach that encompasses all expenditure priorities provides an integral framework for effective implementation of policies and programmes.

6. Failure to link policy, planning and budgeting may be the single most important factor contributing to poor budgeting outcomes at the strategic and operational levels in the states. Unpredictability of funding, failure to direct resources to policy priorities, absence of effective decision-making processes, and lack of understanding of inter relations lead to unsatisfactory budgetary outcomes. Overall, this leads to a massive mismatch between what is promised through government policies and what is affordable or achievable. The annual budgeting process therefore becomes more about scrambling to remain afloat meeting committed expenditures, rather than allocating resources on the basis of clear policy choices to achieve strategic objectives.

7. In many countries, budgeting has been undermined by the “needs” rather than “availability” psychology of the budget makers. While finance ministries stress "availability", line departments persist in basing budget proposals on “needs”. The result is a negative-sum budget process that keeps grappling with imbalances. The

challenge is to resolve the pulls of "needs" and pressure of "availability" more effectively. A medium-term approach provides such a linking framework. Future resource allocations based on a specific policy mix will be more predictable where a medium-term framework enforces discipline.

8. The Government of Uttar Pradesh has enacted a Fiscal Responsibility Legislation in 2004. The Act requires that the state government, at the time of presentation of the annual budget, will lay before both the Houses of Legislature a Medium Term Fiscal Restructuring Policy, containing all assessment of the revenue receipts and expenditure of the government, and also the use of capital receipts including borrowings for generating productive assets. The Medium Term Fiscal Restructuring Policy will set forth five-year rolling targets for the prescribed fiscal indicators.

9. The Medium Term Fiscal Restructuring Policy will, among other things, lay down the medium term fiscal objectives of the state government, assess the performance on the basis of the prescribed fiscal indicators *vis-à-vis* the targets set out in the budget. It would also lay down priorities and targets of the state government in the fiscal areas for the next financial year which relate to taxation, expenditure, borrowings and other liabilities, lending and investments, pricing of administered goods and services, guarantees and activities of Public Sector Undertakings that have potential budgetary implication.

10. The Twelfth Finance Commission in its recommendations has also given to Uttar Pradesh a set of conditional grants, which require assimilation in their budgetary exercises. In the normal course also, Uttar Pradesh receives, like many other states, funding from the Central Ministries under the Centrally sponsored schemes, which require counterpart funds. A budget should carry out the allocation exercise to optimise receipt of funds from the Central Government in sectors that require enhancement of service standards according to central and states' own priorities. The TFC has also recommended a debt-relief scheme consisting of two parts.

11. The budget of the state Government should, therefore, be prepared consistent with these conditionalities and the medium term targets. No budgeting exercise can be considered reliable if it does not take into account the existing and potential changes in the macroeconomic environment. This means that in making the budget, a good understanding of economic growth, its sectoral composition, and the rate of inflation is properly taken into account. This may require capacity building at the state level for analysing and forecasting output and inflation trends.

12. The Government of Uttar Pradesh will do well, as part of the overall budget reforms, to undertake outcome budgeting, initially covering some critical social services like education, health and water supply and sanitation, and progressively increasing its scope. The Central Government has introduced outcome budgeting for the first time during the current financial year. Although, it is quite limited in its scope. Outcome budgeting should serve as a major tool for increasing the efficacy of government expenditures.

Monitoring the Quality of Budget Estimates

13. The budget of any one year contains the budget estimates for the forthcoming year, revised estimates for the current year, and actuals for the preceding year. In an efficient budgetary system, the capacity of the budget estimates to reflect the actual outcomes is an essential requirement for efficient fiscal intervention.

14. In this study, the predictive quality of major budgetary aggregates for Uttar Pradesh has been reviewed focusing on eleven variables: own tax revenues, share in central taxes, own non-tax revenues, plan revenue expenditure, non-plan revenue expenditure, interest payments, capital receipts, capital expenditure, revenue deficit, fiscal deficit, and primary deficit. The analysis has been carried out not only in terms of levels but also in terms of first differences. In many cases, systematic biases have been noted. Serial correlation in prediction error indicates scope for improving the quality of budget estimates.

Ex-Post Budget Processes and Feedbacks

15. All expenditures appropriated in a budget for period t must be actually incurred in that period. All budgetary processes in period (t + 1) that relate to the budget of period t, are therefore ex-post. Further, a detailed process of verification and scrutiny is undertaken by the Comptroller and Auditor General of India, and various Legislative Committees.

16. Audit of Government transactions is one of the most important instruments of control over the government finances. The legislature has the powers to grant appropriations to the executive for public expenditure. The CAG examines the annual accounts of state governments to satisfy whether the money granted by the Legislature is spent on purposes for which it was intended and that it has been spent according to the law, rules and regulations.

17. We have looked at some of the Audit observations based on Finance Accounts and Appropriation Accounts of Government of Uttar Pradesh during the years 2000-01, 2001-02, and 2002-03 as well as those, which had come to notice in earlier years but could not be dealt with in previous years.

Summary and Recommendations

18. In the case of Uttar Pradesh there is, in budgetary terms, a tendency for habitually overrunning voted appropriations with an undue reliance on supplementary demands and ex-post approvals. Individual departments are following the practice of making incremental demands for grants without much reference to the needs of their sectors or a recognition of the overall resource constraint. In a situation like this, the Department of Finance has to take a synoptic view and perform the role of a coordinator of individual spending claims keeping in view the FRBMAs stipulations.

19. Budgetary reforms are critical to improving the efficiency of state's fiscal intervention. The objective of budgetary reform should be to improve the outcomes in terms of the quality, extent and reach of publicly provided services by the state Government.

20. In order to undertake budgetary reforms it is important to take action on the following:

   i. At the level of the Finance Department, procedural changes that strengthen a synoptic view of the budget, maintaining consistency with a medium term policy.

   ii. Restoring the Budgetary Cycle will help in better fiscal management if the various departments adhere to the provisions of the Budget Manual.

   iii. There is need for building up technical capacity for using modern forecasting methods with assimilation of all relevant information regarding the changes in the fiscal parameters due to state level and national level fiscal policy changes.

   iv. Transparency is a critical attribute of efficient budgets. The more transparent is a budget, the more effective will be its impact.

   v. There is a need to link the department of finance with all line departments and agencies for on-line compilation and collation of expenditures and revenues. This will help prepare the annual budget document more effectively.

   vi. Although the appropriations of a budget relate to only one year, expenditure cycles, particularly in the case of capital expenditures is normally of more than one year. It is important, therefore, to give approvals for expenditures for longer than one year period and develop mechanisms whereby sanctioned amounts do not lapse. This applies to other states also and may require legislative changes. This will also obviate the problem of using too many PL accounts on an *ad hoc* basis.

21. Important elements of budgeting reforms in Uttar Pradesh should include the following:

   i. The annual budget should be formulated keeping in view the medium term fiscal policy. This may be done in the context of the UP's FRBMA. This medium term policy should be presented to legislature along with the budget.

   ii. A separate schedule indicating major head-wise number of employees, and salaries and allowances should be presented in the budget along with proposed reforms.

   iii. Separate schedule on pensions and terminal benefit outflows along with number of pensioners. There should be an estimate of the likely pension bill for the next five years.

   iv. A major head-wise schedule of subsidies, making as many subsidies explicit as possible. In other cases, the amount of implicit subsidies should be estimated and given. The methodology of such estimation should be standardised and stated explicitly.

   v. A schedule of year-wise and project-wise outstanding guarantees (this has been initiated in UP).

vi. Computerisation of budgeting methodology and procedures quarterly flows of receipts and expenditures also should be announced and monitored.

vii. Statement on the deviations between actuals and budget estimates should be presented, and an analysis of factors explaining the deviation should be undertaken leading to continuous improvement in the estimation methodology.

viii. An active cash-flow management strategy should be activated so as to keep the cost of managing temporary mismatching between receipts and expenditures at a minimum.

Abbreviations

AIBP		Accelerated Irrigation Benefit Programme
BFC		Budget Finalisation Committee
CAG		Comptroller and Auditor General of India
CMDF		Chief Minister's Discretionary Fund
FRBMA		Fiscal Responsibility and Budget Management Act
GSDP		Gross State Domestic Product
MOF		Ministry of Finance
MTEF		Medium Term Expenditure Framework
NABARD		National Bank for Agriculture and Rural Development
PLA		Public Ledger Accounts
RMSE		Root Mean Square Error
SC		Scheduled Caste
SSA		Sarva Shiksha Abhiyan
ST		Scheduled Tribe
TFC		Twelfth Finance Commission
TIC		Theil Inequality Coefficient
UP		Uttar Pradesh
UPHSDP		UP Health System Development Project

Chapter 1: Budget Process: Concepts and Objectives

1.1 Introduction

The word ‘Budget’ is derived from the French word ‘Bougette’[1], which means a small leather bag or pouch. It was first used in England to describe the white leather bag that held the seal of the medieval court of the Exchequer. Later, the Chancellor of the Exchequer’s bag, containing his proposals for financing Government expenditure came to be known as his ‘Budget’.[2] In India, the British introduced the budget for the first time in 1960.[3] It was a line-item budget. It was for the first time in 1954 that the Estimates Committee of Parliament suggested introducing Performance budgeting in India.

1.2 Budgetary Process in the States

The expenditure responsibilities as well as the resource raising domains are clearly specified in the Constitution of India, both for the Union Government and for the State Governments. Under Article 202 of the Constitution, in respect of every financial year, a statement of the estimated receipts and expenditure of the state for that year, called the "annual financial statement" (or the "budget") is to be laid before both House of the State Legislature.

a. Structure of Government Accounts and the Budget

Budget statements provide a summary of all the Government transactions. All the Government transactions are accounted for in three funds:

i. Consolidated Fund, which consists of all revenues received by the government, loans raised by it, and also its receipt from recoveries of loans granted by it. All government expenditures are incurred from this fund with the authorization of the Legislature.

ii. Contingency Fund from where the government meets its unforeseen expenditure pending its authorisation by the Legislature.

iii. Public Account, which consists of receipts and disbursements such as deposits, reserve funds, remittances, etc., which do not form part of the consolidated fund, are included here. Disbursement from the public account is not subjected to vote by the Legislature.

The consolidated fund accounts have two divisions (i) Revenue Account and (ii) Capital Account. In the contingency fund also the divisions are the same as in the consolidated fund. In the public account, the two main divisions are (i) debt (other than those included in the consolidated fund) and (ii) remittances. Each division of the accounts has different sections, sectors and heads (Refer to Figure 1.1). The sections and sectors are further classified under major head, sub major head, minor head, sub head, detail head as per requirement.

Figure 1.1: Structure of State Budgets

Revenue		Capital	
Receipts	Expenditure	Receipts	Expenditure
Tax Revenue	General Services	Net Borrowing	General Services
Non-Tax Revenue	Social Services	Recoveries of Loans and Advances	Social Services
Grants in Aid Contributions	Economic Services	Other Non-Debt Receipts	Economic Services
	Compensation and Assignment to Local Bodies		Loans and Advances

In India, both at the level of the Centre and the States, the responsibility for preparing the budget devolves on the executive. Following the tradition followed by the British administration in India, budget estimates are prepared by the Union and State Governments for the financial year commencing on 1^{st} April and ending on 31^{st} March of the ensuing year. The exercise of preparing the estimates of revenue and expenditure begins some eight months in advance with the issue of the budget circular by the budget division of the Finance department. Thus the Budget formulation process in India (for both the Union and State Governments) for the ensuing financial year starts in the month of September of the current year when the Budget division of the Ministry of Finance or Department of Finance issues a 'budget circular' seeking statement of budget estimates from the various ministries, departments, or organisations concerned. This circular contains, among other things, a caution that the public money has to be spent with utmost economy. The basic principle of budgeting is that one who spends money should also prepare the estimates in advance. However, the spending departments need some basic guidelines for the preparation of the budget estimates within the overall framework of Government policy and programmes and schemes of respective departments.

The budget circular along with skeleton forms and instructions are sent by the Finance department to administrative departments and controlling officers. Controlling officers are usually the executive heads of departments, who are entrusted with the responsibility of submitting their budgetary requirements to the Government and are accountable for monitoring the budgetary process and controlling expenditure. The controlling officers issue further guidelines to the estimating officers for preparing budget estimates in the light of the budget circular and their departmental requirements. The controlling officers are required to follow the instructions in the budget circular and prepare estimates accordingly and submit them to the Government within specified time as per the budget calendar.

1.3 Successive Stages of an Expenditure Budget

The budget of a given year t, is initiated in period (t - 1), gets implemented in period t, and is subjected to ex-post accounting, evaluation and performance checks in period (t + 1) and beyond. These steps may be divided into four successive stages, *viz*., Government Stage (G), Legislative Stage (L), Implementation Stage (I), and Stage of Ex-Post Control (E) (see, e.g., Alesina and Perotti, 1996). These stages may alternatively be called as budget formulation, approval, implementation, and follow-up stages.

For the budget of a given year, therefore, different stages are traversed through in a number of years, preceding, as well as succeeding it. Conversely, in any given year, budgetary activities pertaining to the budgets of the previous year(s), current year, and the succeeding year occur concurrently. A stage-wise, year-wise schematic representation of the budgetary process is given in Figure 1.2.

Figure 1.2: Stage-Wise and Year-Wise Path of a Budget

Budget of	Stage in Year		
	t – 1	**t**	**t + 1**
t – 1	L, I	E	E
t	G, L	L, I	E
t + 1		G, L	L, I

G = Government stage; L = Legislative stage; I = Implementation stage; E = Stage of ex-post control.

Several budgeting activities take place in a year. Ex-post stage of many of the previous budgets may occur simultaneously in a given year. Maximum legislative attention is paid to the consideration of the current budget. The government is also concerned relatively more with the passing and implementation of the current budget. The ex-post budget control activities, pertaining to the previous years, often keep accumulating, and the degree of attention progressively declines as the concerned budget recedes in time.

1.4 Government Stage

In this stage, individual spending departments formulate their expenditure plans that are forwarded to the Department of Finance for screening and integration into the main budget. The state government finalises the budget with the help of and in the Department of Finance. Because of confidentiality, tax and expenditure plans are not revealed prior to formal presentation to the legislature. Discussions at the cabinet level often relate only to the general policy issues. Specific magnitudes of expenditure remain with the Department of Finance.

The government stage of the budget for period t, gets started in period (t - 1) and can be divided into several sub-stages. The process is initiated by the issue of the 'Budget circular' (mid-September in period t - 1) from the Department of Finance. The circular is addressed to various Departments. Different departments furnish estimates of expenditure to the Department of Finance, which embarks upon the process of compilation and coordination of estimates of expenditure of different departments. Between September to February, the government stage passes through the following steps: (i) issue of budget circular giving general guidelines and calling for submission of estimates; (ii) preparation of estimates of expenditure by different departments; (iii) finalisation of individual estimates of expenditure, compilation and coordination, and finalisation of specific demand for grants for each department.

1.5 Legislative Stage

The current budget is presented to the legislature, usually in March, towards the end of the previous financial year. Discussions may continue until May. Thus, the legislative stage of the budget comprises a period running from the end of February to May. From the presentation to the passing of the Appropriation Bill, the process takes about two months. Since supplementary demands may be raised from time to time, the legislative stage, in fact, continues throughout the financial year.

The legislative stage consists of (i) presentation of the budget (annual financial statement); (ii) debate on revenue and expenditure proposals; (iii) specific discussion of individual demands for grants; (iv) replies to debates by individual Ministers and the Minister of Finance; (v) voting by legislature; and (vi) passing of appropriation bills.

1.6 Implementation Stage

The implementation stage starts after the appropriation bills have been passed by the legislature. Once the appropriations are voted and approved by the legislature, spending authorities are authorised to draw the necessary amounts and spend. To each spending department, the respective budget allocation is communicated, usually by the end of May. The necessary information is then transmitted to various offices, and controlling and disbursing officers giving details of sanctioned amounts in each case. The appropriated amounts must be spent during the current financial year. All funds voted by legislature, i.e., initial budget grants as well as supplementary grants lapse at the end of the financial year. That is why the implementation stage is peaked with “March” spending. Within the financial year, subject to specified rules, there is a possibility of reappropriation between expenditure heads. General restrictions provide that reappropriation cannot be done (i) between voted and charged items of expenditure, and (ii) for meeting expenditure on a new service or new instrument of service not provided for in the budget. Expenditure of each spending ministry is overseen by its financial adviser who prepares monthly and quarterly reports on expenditure incurred. He also transmits monthly accounts to the CAG for the preparation of consolidated accounts for the government.

1.7 Requirements of Budget Preparation

The main points required to be kept in mind by controlling and estimating officers while preparing the budget estimates are as follows:

i. Estimates should be prepared keeping in view the constraints on financial resources of the state so that no important items of work suffers for want of funds on the one hand and no avoidable item of expenditure gets a place in budget estimates on the other.

ii. Estimates should be prepared separately for

- Revenue receipts
- Revenue expenditure
- Capital receipts and expenditure
- Estimates of non-plan expenditure
- Estimates of plan expenditure
- Estimates of centrally sponsored schemes
- Estimates of commercial schemes
- Estimates of loans and advances and recovery thereof
- Estimates of continuing schemes
- Estimates of new schemes and new items of expenditure.

iii. The estimates of revenue and expenditure should include only that amount, which is likely to be received or spent in the year for which estimates are being prepared.

iv. Efforts should be made so that the budget estimates should neither be over-estimated nor under-estimated but remains close to actuals.

The exercise of preparing the budget for the ensuing financial year gets into motion with the issue of the budget circular in the month of August-September (see Annexure 1). The entire government machinery right from the Finance department to the Head of the departments and down to the level of estimating officers gets engaged in the process of formulation of the budget and in collecting necessary details and making different types of calculations.

The next phase relates to budget finalisation by the Finance Department. The estimates are scrutinised by the Finance Department through the system of holding department-wise meetings.

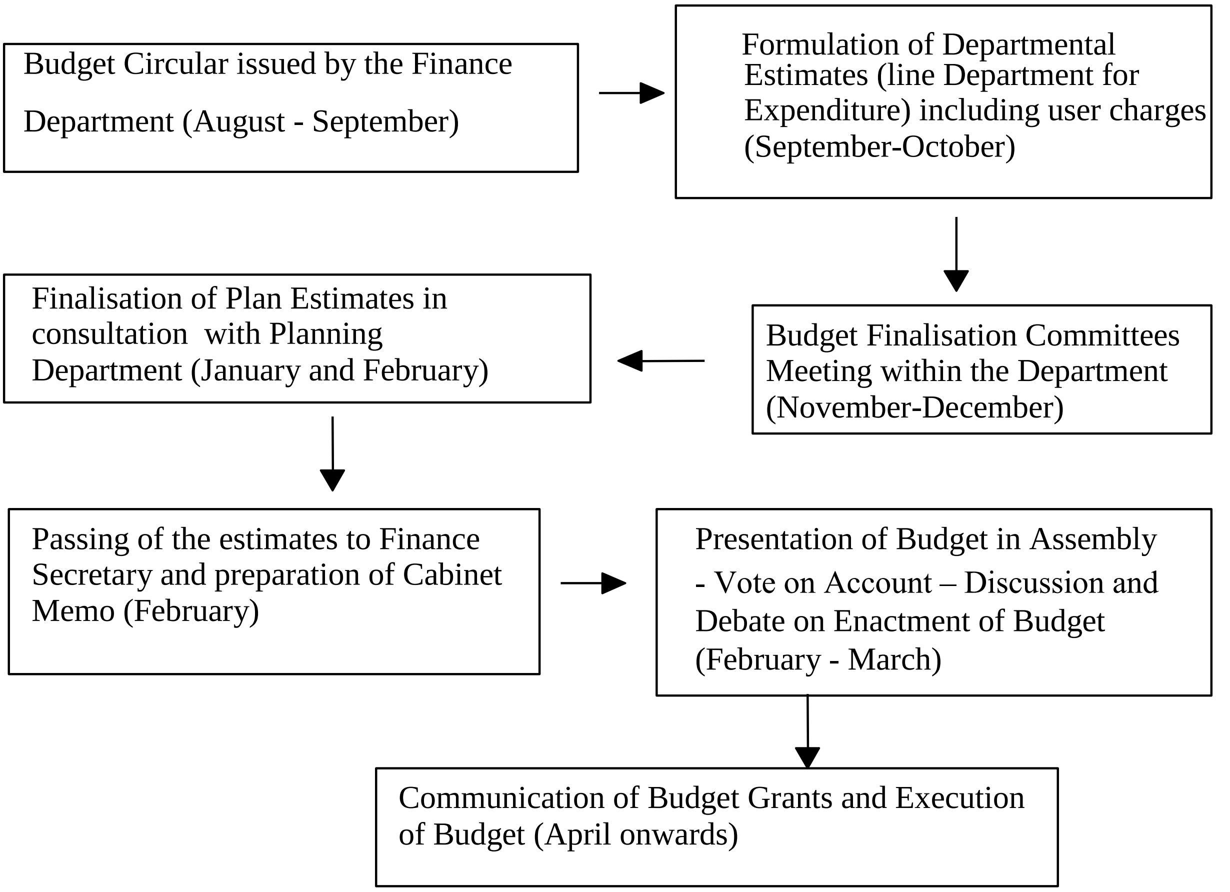
After the finalisation of the budget, it is presented, under Article 202 of the Constitution, to both the houses of the state Legislative Assembly on the recommendation of the Governor in February. After the presentation, some period is specifically allotted for the general discussion on the budget. In the next step, individual demands are taken up for discussion and voting by the House. After the voting of demands, appropriation bill is introduced by the Finance Minister in the House. The passage of appropriation bill is necessary because no money can be withdrawn from the Consolidated Fund, unless it is authorised by the law. After the voting on the appropriation bill, the Finance Bill is taken up for consideration. After its passing, it becomes as the ‘Finance Act’. With the passing of these two bills the budget approval stage is over. If the voting on these Bills or on any other financial business goes against the Government, it is treated as a vote of no confidence against the Government.

Approval of the budget by the Assembly is the most important stage in the budgetary process in a state. The implementation process of the budget starts after the legislative approval. The budgetary process is illustrated in a schematic form in Figure 1.3.

1.8 Expenditure Categorisation

In the Constitution, a distinction is made only between revenue and ‘other’ (i.e., capital) expenditures. But over time, expenditure categories pertaining to developmental and non-developmental and Plan and non-Plan, have evolved. This excessive partitioning of expenditures adds to the opacity of budgetary handling of government expenditures. Excessive emphasis on Plan expenditure has under-emphasised the maintenance of capital assets as an objective. The Tenth Finance Commission (Report, p. 64) had observed: “… the present artificial distinction between Plan and non-Plan expenditures, which runs across revenue and capital budgets … be replaced by the simpler and conventionally well recognised distinction between revenue and capital”. The Eleventh and Twelfth Finance Commissions have also highlighted several inefficiencies that result from this excessive classification. In particular, vertically needed maintenance expenditures receive low priority leading to fast depreciation of assets.

Figure 1.3: Budgetary System in a State: Various Stages



1.9 Requirements of a Good Budget

A sound budget and system of financial management will, according to the World Bank Public Expenditure Management Handbook, be achieved by the following features, among others.

i. *Comprehensiveness:* In India, as in many developing countries in the world, the annual budgetary process is the only mechanism where a Parliamentary or Legislative approval is required for tax policies and expenditure allocations. It is therefore, required that the budget contains all the fiscal operations of the Government in a comprehensive way such that it could be scrutinised as a complete statement of Government's fiscal operations.

ii. *Legitimacy:* This means that there is an approval by the Legislature or the Parliament according to the prescribed laws and rules. Legitimacy also requires that the departments adhere to approved expenditures according to the needs of their sectors as approved by the public representatives.

iii. *Flexibility:* In an operational sense departmental level heads should have a degree of flexibility in allocations, appropriations, re-appropriations according to the requirements of the programmes under their supervision.

iv. *Predictability:* Predictability is important for efficient and effective implementation of policies and programmes. It also facilitates the private sector to dovetail its own activities to the Government sector operations.

v. *Transparency and Accountability:* These require that decisions, together with their basis and the costs that are involved, are clearly represented and communicated to the Legislature and the community at large.

The "transparency" of the budget and budget procedures is crucial for better fiscal outcomes. The real balance of the budget, both current and future can easily be "hidden" in the "complexity" of the budget. Alesina and Perotti observe (1996, p. 16): "Politicians have incentives to 'hide' taxes, overemphasise the benefits of spending, and hide government liabilities, equivalent of future taxes. Politicians have little incentive to produce simple, clear and transparent budgets". Techniques by which the opacity of the budget are often increased include (i) strategic use of budget projections, (ii) underestimation of interest rates, (iii) overstatement of the effects of proposed budgetary changes, (iv) keeping various items off the budget with a "creative" use of the budget of other public organisations not incorporated in the budget, (v) creation of various funds, and extensively using transfers to and from these funds, and (vi) strategic use of multi-year budgeting by announcing more-than-one-year adjustment plans, and extending the adjustment horizon year after year.

A coherent approach to budget reforms will involve the following four steps:

i. *Aggregate and Binding Fiscal Targets:* Many states have embarked upon fiscal reforms. This is in response to a period of large and growing fiscal imbalance. One important step in making a budget is to define the annual targets within a medium term framework and then stick to these in the annual budgets.

ii. *Incentive for Improving Allocation and Utilisation of Resources:* Since the resources are limited and various services are competing for these resources, the budget should have to face hard allocation choices. This must be made with due procedure but also keeping in mind the outcome of the budgetary allocations.

iii. *Autonomy of Departments:* In order to improve the performance and the impact of the budget, departmental heads or line managers should be given greater autonomy in managing their budget. This amounts to decentralising responsibilities to the departmental and further to the field level.

iv. *Outcome Budgeting:* Financial allocation and financial expenditures are not enough. The impact of expenditures should be traced through the outcomes.

1.10 Systematic Errors in Budgetary Prediction of Expenditures

An expenditure system that is managed on the basis of poor forecasts (budget estimates) is bound to be inefficient. Poor expenditure forecasts are less understandable than those for revenues, because expenditures are themselves approved amounts, and entirely under the control of the spending agencies.

1.11 Supplementary Budgets

Supplementary budgets are needed when the forecasts on the basis of which the original budget was prepared go wrong in the wake of unanticipated increases in prices, exogenous shocks, and other unforeseen events. Supplementary budgets do not get the same public or legislative attention as the main budget and can often serve to increase the opacity of the budget. The better the forecasting framework on which the main budget is based, the lesser would be the need for supplementary demands.

1.12 Cash Flow Management

Bottlenecks in the flow of cash increase inefficiency. Flows of cash receipts and expenditure peaks at different times and have seasonalities of their own, which are not synchronous. The financial advisers of departments/ministries usually put forward a mechanically sub-divided ($1/12^{th}$ of annual figures) forecast. The requirement of short-term borrowing could be minimised, and releases of loans and grants from the Treasury could be synchronised with cash requirements of the spending agencies, if a proper mechanism of cash-flow management is brought in place. State governments in India need to develop an active cash flow management strategy that is synchronised not only with the seasonal behaviour of their own revenue receipts but also with the periodicity of central releases relating to tax devolution and different types of grants.

1.13 Outcome Budgets: Relevance for States

The Union Finance Minister presented in Parliament the first ever Outcome Budget in August 25, 2005. The Outcome Budget is a mechanism to measure the development outcomes of all major programmes carried out by the Government. It is a kind of progress card on what various ministries and departments have done to convert the outlays announced in the annual budget into outcomes. It is a performance measurement tool that helps in better service delivery, decision-making, evaluating programme performance and results, communicating programme goals, and improving programme effectiveness. The Outcome Budget will help gauge the effectiveness of the money spent on various heads by different ministries. It will also help ensure that programmes and schemes do not continue indefinitely from one Plan period to the next, without an independent, and in-depth evaluation.

The Outcome Budget can help in disciplining various ministries in their spending pattern by ensuring that they do not stagger it towards the last quarter of the financial year. It is also aimed at changing the outlook of the government officials with a view to making the government officials more result-oriented and minimising project-delays. It can also curb their tendency to ask for more expenditure to meet the spiralling costs. As a result, the focus will shift from 'outlays' to 'outcomes'. It helps the government to make its budgets more cost effective, doubles up as a major device to fix accountability, enabling the government to manage its schemes better. This system will ensure that all stakeholders, *viz*., people's representatives, the civil society, and those for whom the scheme is being implemented can check for themselves how well a project is being implemented. It needs to be recognised that development and implementation of the 'outcome budget' would be an on-going process, regularly revisited for reality check, and the structure now being put in place would be further honed and refined.

The first Union Government Outcome Budget for 2005-06 is limited in its scope. It covers only 61 departments/Ministries. It covers only the plan schemes. In general, there are 6 columns. The first column indicates the name of the scheme or programme. Taking the Department of Elementary Education and Literacy as an example the name of the scheme would read as Sarva Shiksha Abhiyan (SSA). In this case, the objective/outcome is given in the second column as (i) enrolling all children of 6-14 years in elementary schools/EGS/AIE Centres, and (ii) improving access, enrolment, retention and quality of elementary education.

The third column indicates the outlay for the financial year. The fourth column specifies quantifiable deliverables. In this particular case, an example of the quantifiable deliverable is ‘enrolling all the 8.13 million out-of-school children in regular schools/EGS/AIE Centres’. The fifth column indicates processes or timelines within the financial year. The sixth column indicates the risk factors or other remarks. While an outcome budget of this nature may be helpful in some respects, it requires more information on how the quantifiable deliverables get converted into the stated outcome. In particular the outcomes are long-term phenomenon and in the budgeting exercise only that can be written, which is achievable within the financial year. For example, in the case of SSA the outcome listed as improving access, enrolment, retention and quality of elementary education does not indicate how it can be measured in terms of improvement positions before and after the concerned financial year.

While it is desirable for the State Governments also to embark upon outcome budgeting, it should be done in a progressive manner starting with some key departments and a limited number of schemes. It is suggested that, in the first instance, some important social sector departments like education, health, and water supply and sanitation be taken up. As the concepts become clearer for the implementing agencies, the scope of the outcome budget should be made more comprehensive, covering both plan and non-plan expenditures.

Chapter 2: Designing an Annual Budget: Consistency With Macro Framework and Medium Term Targets

In this chapter, we address issues of linking public policy, planning and budgeting across the whole of government and at the sectoral level while formulating the annual budget. The total expenditure of the Government should be aligned to availability of resources over the medium term. This should be considered in the context of sustainable level of fiscal deficit. Expenditure should be appropriately allocated to match policy priorities, so as to produce the intended results at minimum cost. Affordability must influence policy making and planning at the point when the decision is made. A medium term approach that encompasses all expenditure priorities provides a linking framework and facilitates the management of policies and budget realities to reduce pressure throughout the whole budget cycle. The result is better control of expenditure and greater efficiency and effectiveness in implementing policies, programmmes and projects.

2.1 Synoptic-Hierarchical vs. Fragmented-Collegial Approaches to Budgeting

Von Hagen (1992), Alesina and Perotti (1995, 1996), and Von Hagen and Harden (1996) have put forward the proposition that budget procedures and budget institutions have a major influence on fiscal outcomes. It is argued (e.g., Von Hagen and Harden, 1996) that increased 'centralisation' of the budget processes can help in controlling the bias towards excessive spending. 'Centralisation' refers to all those processes of budget formulation and spending that strengthen a macroscopic and comprehensive view of the budget as compared to the compartmentalised and myopic view of the spending departments. Their theoretical model rests on a consideration of externalities in the context of a 'common pool' problem of government budgeting. While public spending is targeted at individual groups, regions or locations, the tax burden of financing the spending programme is well dispersed over the taxpayers. Policy-makers, representing the spending agencies, take into account the full benefit from expanding the spending programme, but as costs, they only consider that part which falls on their constituencies. Thus, policy makers systematically overestimate the net marginal benefit of increasing public spending. This "common pool" problem is akin to that of exploitation of a common resource by uncoordinated private parties.

Empirical evidence is cited by Von Hagen and Harden (1996) to indicate that countries characterised by stronger centralising features in the budget process are also the countries with a relatively higher degree of fiscal discipline pertaining to spending, deficits and debt. A comparable study of the budget process for 28 Latin American States was carried out by Alesina, *et. al*. (1995). They find that cross-country differences in public sector deficits can be explained by differences in the degree of centralisation of the budget process.

In a more recent contribution, Alesina and Perotti (1996) argue that more hierarchical procedures are associated with more fiscal discipline. They outline hierarchical procedures as those that attribute "more power to the treasury than to spending Ministers in intra-government negotiations" and those that "limit the role of the parliament in amending the budget proposed by the government". Several years ago, Prest (1962, p. 134) had perceptively observed: "On these grounds, therefore, one must make a very strong plea for a budgetary system which enables revenue to be looked at as a whole, and expenditure to be looked at as a whole rather than one which breaks down each side into a number of pieces or one which matches specific items of revenue with specific items of expenditure".

2.2 Consistency With a Budget Constraint

An examination of the growth of public expenditures and their poor performance in the context of some of the erstwhile socialist experiments led Kornai (1980, 1986), to formulate his theory of the "soft budget" constraint. A hard budget constraint, such as those faced by individuals and private enterprises, forces decision making units to be responsive to the price signals in the economy, thereby generating substitution effects that are crucial to economic efficiency. On the other hand, when the budget constraint is soft, and is perceived to be soft by the spending agencies, i.e., departments as well as public enterprises, pay greater attention to lobbying for increased budget allocations, rather than exploring the possibilities of input-substitution and resource-reallocation. In the presence of a soft-budget constraint, the compulsion to adjust demand to changes in relative prices is weakened. A perfectly soft-budget constraint would imply a zero response to price changes. When a large number of government departments and public enterprises operate under the perception of soft-budget constraints, the overall efficacy of public expenditure declines due to weak responses to price signals because incentives to improve quality and competitiveness of products, and to reduce costs and introduce new products or innovations are weakened. Lower expenditure efficiency in these units is accompanied by a greater demand for increasing the draft on the general budget.

2.3 Consistency With Time

Time and Deadlines in Decision-Making

In the decision-making hierarchy of government, time *per se* has little value. There is no penalty for delayed decisions and no premium for timely decisions. The result is that decisions are steadily postponed until deadlines arrive. If a deadline is relevant, most of the decisions would be bunched close to the deadline. The phenomenon of "march" spending is well known.

Time itself is an important input in economic processes that are characterised by extensive linkages. If inputs are not procured in time, the related output is delayed, which may set off a domino-kind effect upsetting the subsequent chain of outputs or related decisions. Delay in decisions is often strategically used as a 'message' by rent-seeking decision-making units in governmental hierarchy indicating the need for such action on the part of the private parties (contractors, firms, suppliers) as would induce a favourable and quick decision. The greater is the inefficiency of the system, the larger is the average time of governmental decisions.

Failure to link policy, planning and budgeting may be the single most important factor contributing to poor budgeting outcomes at the macro, strategic and operational levels. In many cases, policy making, planning and budgeting take place independently of each other. Planning is often confined to investment activities. Capital expenditures are already largely accounted for through the planning process, and a large portion of recurrent (or non-plan) expenditures are pre-committed to the salary bill. For this reason, annual budgeting is reduced to allocating resources thinly across donor and domestically funded "investment" projects and to the non-wage portion of the recurrent budget. In addition, line agencies tend to budget and spend on an *ad hoc* basis because even small discretionary allocations are rarely predictable.

2.4 Coping With Uncertainty

Unpredictability of funding, from one year to the next and within the budget year, is one of many factors that contribute to the poor performance. Others that are related to the budget are the failure to direct resources to policy priorities – in significant part because budgeting is treated as an annual funding exercise, not a policy-based exercise. In the absence of effective decision-making processes, policy making and planning are disconnected from each other and from budgeting, and they are not constrained by resource availability or by strategic priorities. Overall, this leads to a massive mismatch between what is promised through government policies and what is affordable. The annual budgeting process therefore becomes more about scrambling to keep *status quo*, rather than allocating resources on the basis of clear policy choices to achieve strategic objectives.

In many countries, budgeting has been undermined by the “needs” rather than “availability” psychology of the budget actors. While finance ministries stress "availability" (the revenues it expects to be forthcoming from domestic and external sources), line ministries persist in basing budget proposals on “needs”. The result is a negative-sum budget process that undermines macroeconomic stability and program and project effectiveness. Integrated policy, planning and budgeting is fundamentally about having expenditure programmes that are driven by policy priorities and disciplined by budget realities. The challenge is to manage the tension between “needs” and “availabilities” more effectively. A medium term approach provides such a linking framework and facilitates the management of the tension between policy and budget realities to reduce pressure throughout the whole budget cycle.

Future resource allocations based on a specific policy mix will be more predictable where a medium term framework enforces discipline. Predictability allows line departments to plan and manage resources more efficiently within the time frame of the annual budget cycle and over the longer term. The result is better control of public expenditures and better value for money within a hard constraint. Increasing predictability of resource flows and the criteria by which funding decisions are made are the main objectives of the medium term approach. In many developing countries, the resource allocation process is plagued by uncertainty, much of which is self-inflicted. The common tendency to make overly optimistic revenue projections is one example of how governments themselves increase the uncertainty of resource flows. The complete mismatch between policy decisions and available resources is another source of uncertainty. It could be avoided by implementing a rigorous process that links policy making, planning and budgeting.

2.5 Developing and Implementing a Medium Term Framework

Developing and implementing a medium term framework for linking policy, planning and budgeting can be accomplished progressively at a pace that suits a state's requirements. Different countries have adopted different strategies for their purpose. For example, some countries (South Africa, Uganda) began by developing an overall medium term framework for allocating resources between sectors through a top-down approach carried out by the Ministry of Finance. Others (e.g., Malawi) began with a more bottom-up approach, focusing first on developing Medium Term Expenditure Frameworks (MTEF) at the sector level to govern resource allocation within individual sectors.[4] Countries often choose to begin at the sector level because this represents a manageable change from the *status quo*. However, this approach should only be viewed as a building block to achieving a comprehensive medium term approach. In the case of Pakistan, the sector approach has proven an important catalyst for focusing attention on government wide systems and processes.

Many of the potential gains at the sector level, however, cannot be realised until the sector approach is combined with a central overall planning, resource allocation and budgeting system that supports a better balance between policies and resources at the inter-sectoral level. Furthermore, too much dependence on a sector focus can limit opportunities for responses that go beyond the sector. Similarly, a framework to allocate resources between sectors can only be fully effective when it is complemented by a similar system for resource allocation within sectors and by information generated by the sector ministries themselves. The ideal, therefore, is to develop a medium term approach to decision-making and resource allocation across the whole of government that combines top-down and bottom-up decision making for expenditure allocation. Clearly, medium term expenditure planning at the sector and government-wide level are linked. Necessary components of government-wide planning include sector (and program) information, a clear indication of affordability, and a mechanism to resolve the tensions between priorities, inter- and -intra sectorally.

2.6 Linking Sector Level Policy, Planning and Budgeting

Years of short-term planning for annual budgets and hand-to-mouth adjustments during the budget year have led to accumulated over-commitments and inefficiencies at the operational level. The separation of policy making, planning and budgeting so often in evidence at the centre of government is replicated at the sector level. The requirement, therefore, is to create enough certainty so that line ministries and agencies can plan ahead, have tangible incentives for doing so, and have better information on which to base strategic and operational decisions. In other words, it requires, at its core, the development and effective implementation of a comprehensive MTEF.

Integrating planning, policy and budgeting at the sectoral level through sectoral MTEF's can result in significant gains and could be the foundation of a comprehensive MTEF. The example of Malawi is a case in point, where the reform process began with the implementation of MTEF's in selected pilot sectors and was then progressively expanded to become comprehensive.[5] Defining and implementing a sectoral MTEF involves preparing estimates of overall resource availability, reviewing financing mechanisms, and preparing prioritised government spending plans. This is clearly not a one-off process. Rather it is iterative and must take into account, on a periodic basis, changes in sectoral needs and priorities and changes in the overall resource availability.

2.7 Sector Level Medium Term Expenditure Framework

Clear identification of sector objectives and policies is the first step in developing a sectoral MTEF. With a clear vision of the sector relevant intra-sector priorities need to be identified and/or revised. Defining the total quantum of resources available to the sector should be as comprehensive as possible. Ideally, it should include resources available to the sector from tax revenue, donors, fee income, voluntary organisations, and private companies. While there is uncertainty associated with making medium term resource projections, efforts have to be made to eliminate uncertainties. This is where the sector approach is weakest. Without the overall perspective of government MTEF that facilitates determination of inter-sectoral allocations, the uncertainties of the sector resource position are magnified.

Decision-makers need to assess the possible expenditure implications of policies, using the sectoral policy priorities developed through the sector review process. In carrying out a cost assessment, a good starting point is to work out what existing policies would cost if fully funded, i.e., if facilities were adequately maintained, if staff were paid a reasonable minimum salary, and if essential complementary inputs were provided. This costing aggregated across the sector yields an estimate of the total requirements within each sector, based on actual costs rather than a percentage increase on the previous years' estimate. Adjustments may need to be made to ensure that the medium term expenditure plan falls within the constraints of the resource framework.

Medium term expenditure projections are useful for these reasons, particularly for demonstrating the desired direction of change. In the absence of a medium term plan, rapid spending adjustments to reflect changing circumstances will tend to be across-the-board and *ad hoc*, focused on inputs and that can be cut in the short term. If these are not policy based, these will not be sustained. By highlighting the expenditure implications of current policy decisions on future years' budgets, medium term spending projections also enable governments to evaluate cost effectiveness and to determine whether they are attempting more than they can afford. Sectoral MTEFs should comprehensively cover all activities and organisations in the sector and focus should be on overall expenditures (not capital and recurrent expenditures separately). A coherent set of policies, programmes and activities for the entire sector needs to be looked at together.

2.8 Comprehensive Medium Term Expenditure Framework: Linking Sectors

A MTEF is a strategic policy and expenditure framework for the whole of government within which ministers and line ministries are provided with greater responsibility for resource allocation decisions and resource use. The MTEF consists of a top-down resource framework, a bottom-up estimation of the current, and medium term costs of existing policy, which require to be matched with available resources.

The objectives of an MTEF are to improve macroeconomic balance by developing a consistent and realistic resource framework; improve the allocation of resources to strategic priorities between and within sectors; increase commitment to predictability of both policy and funding so that ministries can plan ahead and programmes can be sustained; and provide line agencies with a hard budget constraint and increased autonomy, thereby increasing incentives for efficient and effective use of funds.

Preparation and implementation of an MTEF takes place through seven successive steps. The initial stage involves developing the macroeconomic framework, which will be used to make projections of revenues and expenditures for five years. In this exercise, the importance of linking economic projections to fiscal targets and the requirements for constructing and using state level economy models are important.

The next stage involves a sector review process through which sector/ministry objectives and activities are agreed and then costed. The sector review process consists of agreeing on objectives, outputs and activities; reviewing/developing agreed programmes and sub-programmes; and costing agreed programmes. The ministries also need to go through a process of prioritisation to make programme costs match available resources.

With the macroeconomic framework and the sector review output in hand, the Department of Finance should develop a strategic expenditure framework, which analyses the trade-offs between and within sectors of relevant funding decisions. This would be the basis for the establishment of sector expenditure ceilings for the upcoming budget year. This framework should be used to guide the deliberations of the decision-making body (usually Cabinet or the Council of Ministers) that makes strategic resource allocation decisions. The policy framework must enforce aggregate fiscal discipline, which requires a high-level of consensus among the key players. This consensus is essential to ensure that there is discipline in adhering to expenditure targets and to the procedures that have been agreed for adjusting them. The framework needs to cover a medium term time frame (three to five years) and must include clear statements on the following:

- the broad objectives of policy and the role of government in the economy;
- the need for discipline in macroeconomic management;
- targets for broad aggregates of public revenue and expenditure;
- procedures for setting and revising the expenditure framework;
- the responsibilities of key agencies.

The next step requires the main decision-making body in government (Cabinet or Council of Ministers) to make medium term sectoral resources allocations on the basis of affordability and inter-sectoral priorities. This is to be done by defining sector specific budget ceilings for the next three to five years. Indications of resource availability within a medium term horizon provide a basis for predictability so that appropriate strategic and efficient operational decisions can be made and implemented. Sector resource profiles can be derived by establishing a sustainable aggregate ceiling for government expenditures over the medium term, then breaking it down. A medium term perspective increases the scope of effective discretion, e.g., over staffing levels and salary obligations.

2.9 Uttar Pradesh: Fiscal Reform Legislation

The Government of Uttar Pradesh has enacted a Fiscal Responsibility Legislation. The Fiscal Responsibility and Budget Management Act was passed by the Uttar Pradesh Legislature and assented to by the Governor on February 26, 2004. The Act provides for the responsibility of the State Government to ensure fiscal stability and sustainability. It also seeks to enhance the scope for improving social and physical infrastructure and human development by achieving sufficient revenue surplus, reducing fiscal deficit and removing impediments to the effective conduct of fiscal operations of the State Government. This Legislation provides that the revenue deficit of the State Government will be brought to zero by the year 2008-09 and the fiscal deficit will be brought to a level of 3 per cent of the GSDP.

The *Act* states that the state government at the time of presentation of the annual budget will also lay before both the houses of Legislature a Medium Term Fiscal Restructuring Policy. This will contain the assessment of the revenue receipts and expenditure of the government and the use of capital receipts including borrowings for generating productive assets. The Medium Term Fiscal Restructuring Policy will set forth five-year rolling targets for the prescribed fiscal indicators.

The Medium Term Fiscal Restructuring Policy will, among other things, lay down the medium term fiscal objectives of the state government, assess the performance on the basis of the prescribed fiscal indicators *vis-à-vis* the targets set out in the budget. It will also assess the likely performance in the current year as per the revised estimates and statement on the fiscal position of the state. It would lay down priorities and targets of the state government in the fiscal areas for the next financial year, which relate to taxation, expenditure, borrowings and other liabilities, lending and investment, pricing of administered goods and services, guarantees and activities of Public Sector Undertakings that have potential budgetary implications.

The medium term framework stipulates bringing down the Debt-GSDP ratio to 25 percent of GSDP by 2017-18.

2.10 Recommendations of the Twelfth Finance Commission

The Twelfth Finance Commission in its recommendations has given to Uttar Pradesh a set of conditional grants, which require assimilation in their budgetary exercises. In the normal course also, Uttar Pradesh receives, as many other states, funding from the Central Ministries under the Centrally sponsored schemes, which require counterpart funds. A budget should carry out the allocation exercise to optimise receipt of funds from the Central Government in sectors that require enhancement of service standards according to central and states' own priorities.

The TFC has recommended a debt-relief scheme consisting of two parts. In the first part, subject to a state enacting a fiscal responsibility legislation, the outstanding loans of the state owed to the centre as on 11.4.2004 may be consolidated and rescheduled for a period of 20 years at an interest rate of 7.5 percent. The second part is a debt-write off scheme linked to reduction in revenue deficit. These schemes, if the conditionalities are met, could substantially improve the resource position of the state.

The budget of the state Government should, therefore, be prepared consistent with these conditionalities and the medium term targets. No budgeting exercise can be considered reliable, if it does not take into account existing and potential changes in the macroeconomic environment. This means that in making the budget, a good understanding of economic growth, its sectoral composition, and the rate of inflation is properly taken into account. This requires capacity building at the state level for analysing and forecasting output and inflation trends.

Chapter 3: Monitoring the Quality of Budget Estimates

The budget of any one year contains the budget estimates for the forthcoming year, revised estimates for the current year, and actuals for the preceding year. The budget estimates and the revised estimates can be seen as predictions of outcomes that become available in the form of actuals or realisations in due course of time. In an efficient budgetary system, the capacity of the budget estimates to reflect the actual outcomes is an essential requirement for effective fiscal intervention. If revenues are not properly predicted, expenditures would also not be properly planned for. If revenue and fiscal deficits are not correctly predicted, the state may have to resort to unplanned borrowing or undertake unanticipated expenditure cuts.

In this chapter, we review the predictive quality of major budgetary aggregates for Uttar Pradesh. In particular, we focus on eleven variables: own tax revenues, share in central taxes, own non tax revenues, plan revenue expenditure, non-plan revenue expenditure, interest payments, capital receipts, capital expenditure, revenue deficit, fiscal deficit, and primary deficit. This analysis incorporates information from 1990-91 to 2000-01. The year 2000-01 represents a threshold after which the state was bifurcated.

A budget system that is managed on the basis of poor forecasts (budget estimates) is bound to be inefficient. Prest (1962) more than three decades ago observed: "… the general principle that no government can hope to execute its economic policies successfully if its budgetary forecasting is wildly inaccurate seems clear enough." Poor expenditure forecasts are less understandable than those for revenues, because expenditures are themselves approved amounts, and entirely under the control of the spending agencies. Several studies in India, beginning with the early work of Mahesh Chand (1962), and subsequent studies by Asher (1978), Chakravarty and Verghese (1982), Bhattacharya and Anita (1988), and Pattnaik (1990), among others have evaluated the quality of budget estimates in India in terms of forecast accuracy and have rated them as quite deficient.

In analysing the divergences between budget estimates, revised estimates, and corresponding actuals, it is important to identify whether there are systematic biases of over-estimation or under-estimation. Errors may also arise due to misprediction of macroeconomic prospects including GSDP growth rate and central transfers. If there are systematic errors, it is possible to improve the budgetary practices, particularly, by modifying the methods used in preparing the budget estimates.

3.1 Methodology

a. Measuring Prediction Errors

In analysing the different variables, we look at the difference between budget estimates (B), revised estimates (R), and actuals (A). The average level of a variable is indicated by a bar (-) placed above the variable name. The analysis has been carried out not only in terms of levels but also in terms of first differences. The following summary indicators of prediction errors are used.

b. Average Percentage Error

Average percentage error is defined over a period of time by calculating the average of the percentage errors of individual years.

i. Root Mean Square Error (RMSE): This summary measure of prediction error is defined as below.

   $\text{RMSE} = [\ \sum(\Delta P - \Delta A)^{2} / n]$

ii. Theil Inequality Coefficient: This measure is defined as

   $\text{TIC} = [\sum(\Delta P - \Delta A)^{2} / \sum A^{2}_{e}]^{1/2}$

c. Decomposition of the Theil Inequality Coefficient

Theil Inequality Coefficient has been decomposed into mean proportion, slope proportion, disturbance proportion. These are defined below:

Mean Proportion = $(\bar{P} - \bar{A})/M_{P}$

Slope Proportion = $(\sigma_{P} - \gamma\sigma_{A})/M_{P}$

Disturbance Proportion = $(-r^{2})\sigma_{A}/M_{P}$

Here, P and A are predictions and realisations. σ_P and σ_A relate to the variances of the two series. r is the coefficient of correlation. M_P is equal to the mean square error, which is the square of RMSE defined above. P and A are taken as first differences in the above analysis. The bias proportion indicates the relative contribution of systematic under- or over-estimation.

d. Regression of Current Error on Previous Error

An alternative test of whether or not systematic factors are left out in making the budget estimates is to test for auto-correlation in error terms. This involves the regression of error in the current period (e_t) on the error of the previous year (e_{t-1}), where 'e_t' is defined as ($D_A - D_P$). 'P' is the prediction of the actual, either through the budget or revised estimates. The prefix D denotes first difference.

3.2 Analysis of Variables

a. Own Tax Revenue

In terms of the budget estimates of own tax revenues there is a clear change over in the nature of error. Table 3A.1 indicates that the budget estimates are lower than the actuals in the early part of 1990s. This continues upto 1996-97. Since 1997-98, the budget estimates of own tax revenues are higher than the actuals. This is also reflected in Table 3A.2, where the percentage error of budget estimate *vis-a-vis* the actuals is given. The tendency for over-estimation of own tax revenue is visible in the case of revised estimates for the period from 1997-78 onwards. Chart 3A.1 shows the levels of budget estimates, revised estimates, and actuals for own tax revenues. Until 1997-98 the curves keep close together. The budget estimate curve rises tangibly above the curve indicating the actuals. In Chart 3A.2, this comes out even more clearly. The percentage error is defined as [(Actual minus Budget Estimates)/Actual]. Chart 3A.3, compares the predicted changes in own tax revenues. Here, changes are defined as follows:

D_A = Difference of actual of current year from that of the previous year.

D_P = Difference of budget estimates of current year from revised estimates of the previous year.

Once the predictor is taken in terms of the first difference, the deviation from the difference of the actual appears to be sharper as indicated in Chart 3A.1. In terms of the average percentage error over the period 1990-91 to 2000-01, it does not appear to be too large at 1.52 percent. The Theil Inequality Coefficient defined in terms of first difference is 0.641. The largest contribution comes from the slope proportion, which indicates that the estimation procedure is not able to capture the variance of the predicted variable properly.

b. Share in Central Taxes

For a state like Uttar Pradesh, the importance of the share in central taxes can not be understated because these tend to be almost as important as their own tax revenues. In incorporating budget estimates of the share in central taxes, often either the centre's budget estimates or those provided for by the Finance Commission are taken. During the 1990s, the actuals relating to the share in central taxes generally turned out to be larger than the corresponding budget estimates.

The few years in which an exception is observable are 1993-94,1995-96, and 1998-99. In Chart 3B.2, we look at the differences between actuals, budget estimates, and revised estimates. It is the departure from the horizontal axis crossing through the origin, which indicates the extent of the error. In absolute terms, these errors have grown over time. The regression of the error term on its lagged term indicates a significant auto correlation, which means that there are systematic errors.

c. Own Non-Tax Revenue

Budget estimates of own non-tax revenues, as compared either to own tax revenue or the share in central taxes, contains larger prediction errors. The percentage error during 1990-91 to 200-01 is 4 percent. However, the t-statistic in the autoregression of the error term does not appear to be significant. One would conclude that although the magnitude of error is relatively large, systematic elements are not responsible for this.

d. Plan Revenue Expenditure

On the expenditure side, we first look at the quality of the budget estimates of plan revenue expenditure. Here, a clear trend of over estimation is indicated in ten out of eleven years under review. The magnitude of error, in terms of the percentage of difference between the budget estimates from the corresponding realisations has increased over time. In 1997-98, the error was more than 50 percent. There was hardly any correction in the revised estimates. The t-statistic of the autoregression of the error term is significant and the magnitude of coefficient is high at 0.55. The pattern is also clearly visible in the charts where the budget estimates and revised estimates lines lie above those indicating the actuals.

e. Non-Plan Revenue Expenditure

Chart 3E.3 shows that at least in terms of levels, non-plan revenue expenditure is well predicted. The budget estimates turn out to be quite close to the actuals. It is only in the latter part of the 1990s, that an overestimation becomes visible. Both the budget estimates and revised estimates are higher than the corresponding actuals. In terms of the decomposition of the Theil Inequality Coefficient, the largest contribution is of the disturbance proportion, which means that the variations, are largely due to random factors. However, the prediction error in terms of the first differences is significantly correlated to its lagged term. This means that there is a scope for improving the prediction performance by taking account of systematic factors.

f. Interest Payments

The quality of budgetary projection in regard to interest payments appears to be reasonable. Chart 3F.3 shows, however, that it has not been possible to project the changes in a manner such that the turning points are well captured. Also, there are systematic factors left out as the coefficient in the regression of the error term on its lagged value is significant and positive.

g. Capital Receipts

Capital receipts indicate primarily receipts on account of borrowing. The general tendency has been to overestimate borrowing in the budget estimates. This tendency is even stronger in the case of revised estimates. The average of the percentage error in the case of revised estimates was about 8 percent. The Theil Inequality Coefficient is close to 1 and the first differences show large deviations. The error term is significantly autocorrelated indicating that the predictive performance can be improved by taking account of systematic influences.

h. Capital Expenditure

In the case of capital expenditure, the tendency to overestimate is even stronger and it applies to both the budget estimates and revised estimates. The average percentage error of over estimation in regard to budget estimates is 7 percent and it is even higher in regard to the revised estimates at 13 percent. The Theil Inequality Coefficient is high at 1.5. The contribution of the slope proportion in the decomposition of the Inequality Coefficient is close to 50 percent. Clearly there are systematic factors being left out in estimating the likely capital expenditures.

i. Revenue Deficit

It is the projection of the revenue deficits, which is the most revealing test of the capacity of the Finance Department to prepare accurate budgetary estimates. As Table 3I.2 shows, the average percentage error in the case of revenue deficit is 25 percent. There has been an important change in the nature of bias. Throughout the period from 1990-91 to 1997-98, there was an overestimation of the deficit. Then, the budget estimate was higher and the actual turned out to be lower. It is from 1998-99 that actuals have continuously exceeded the budget estimates. There are systematic elements in the projection of revenue deficit, which are being left out. The error term is significantly and serially correlated with its own lagged term.

j. Fiscal Deficit

Almost a similar pattern is visible in the case of fiscal deficit. In the period from 1997-98, the budget estimates were higher than the actuals. This position changed in 1998-99. Clearly the budget estimates exercise, which has largely been on an incremental basis, could not take into account the structural changes that would lead the state to borrow at a growing rate. Table 3I.2 shows the average prediction error of the budget estimates is about 23 percent. The error term is also significantly and positively correlated within its lagged term.

k. Primary Deficit

Primary deficit is the outcome of fiscal deficit and interest payments. In estimating primary deficit, the misprediction of both fiscal deficit and interest payments may sometimes multiply to give larger errors. As shown by Table 3K.2, the average prediction error is about 52 percent. In this case, a clear bias of over or under estimation is not visible. However, the error term is serially correlated, which means available information could not be used fully to improve the predictive performance of the budget estimates.

This analysis of predictive performance of the budget estimates highlights the need to build up technical capacity so that the budget estimates can become better guides for the corresponding actuals.

Chapter 4: Ex-Post Budget Processes and Feedbacks

In this chapter, we look at those aspects of the budget, which take place after the implementation of the budget. All expenditures appropriated in a budget for period t must be actually incurred in that period. All budgetary processes in period (t + 1) that relate to the budget of period t, are therefore ex-post. If any amounts have been spent in excess of appropriations, these must be duly approved subsequently. Further, a detailed process of verification and scrutiny is undertaken by the Comptroller and Auditor General of India, and various Legislative Committees. These exercises should normally be completed within one year, but in practice, they take much longer.

i. Authorisation of Excess Expenditures

At the end of the financial year, all voted amounts lapse. On the other hand, if there has been excess expenditure, it requires ex-post approval. This approval is given under Article 151 of the Constitution whereby excess of actual expenditure over sanctioned grants, as brought out in the audit reports of the CAG, are regularised.

ii. Ex-Post Control by CAG

The Comptroller and Auditor General of India is required under Articles 149, 150 and 151 to prescribe the format in which the accounts of the Union and the States are to be kept. As such, the classification of the heads and sub-heads is prepared by the CAG. The CAG, under Article 151, is required to present a report relating to the accounts of the Union and the states, which is then laid before Parliament or Legislature. The report of the CAG amounts to the issuance of a "certificate" which reads as follows: "These accounts have been examined under my direction in accordance with the requirements of Articles 149 and 151 of the Constitution of India and the Comptroller and Auditor General's Act, 1971 on the basis of the information and explanations that my officers required and have obtained, and according to the best of my information … subject to the observations in my Report …". It is these "observations" of the CAG, which summarise the objections and irregularities in expenditures in relation to voted and charged expenditures in the budget. The traditional auditing is regulatory in nature. But, observations are also included that comment on the economy and efficacy of public expenditure programmes.

iii. Parliamentary Control in Ex-Post Stage

At the ex-post stage, the legislature also exercises control over expenditures through a number of committees. The public accounts committee is the primary body concerned with an ex-post examination of the expenditures incurred. It examines whether expenditures approved by legislature have been properly spent within the scope of the concerned demand. It also examines cases that involve losses and financial irregularities. The committee on public undertakings performs a similar function in respect of these undertakings. It examines the CAG reports on expenditures incurred by the public undertakings in the more general context of autonomy and efficiency of public undertakings and evaluates their performance as business enterprises.

Audit of Government transactions is one of the most important instruments of legislative control over the finances of the government. The legislature has the powers to grant appropriations to the executive for public expenditure. But mere powers to grant funds will be in vain unless the legislature has the means to see that the money voted by it is spent by the executive on the purposes for which they are voted. This in ensured by the provision of audit of Government transactions by an independent authority. Under the Constitution of India, it is done by the Comptroller and Auditor General (CAG) of India, who examines the annual accounts of the Central and state Governments to satisfy whether the money granted by the Legislature is spent on purposes for which it was intended and that it has been spent according to the law, rules and regulations. He presents his report to the legislature and brings into notice cases of waste and inefficiencies.

4.1 Audit Observations for Uttar Pradesh: Selected Items

Audit observations based on Finance Accounts and Appropriation Accounts of Government of Uttar Pradesh in recent years show several important lapses. The cases mentioned in the Report of the Comptroller and Auditor General of India (Civil) for the Government of Uttar Pradesh are among those, which came to notice in the course of test-audit of accounts during the years 2000-01, 2001-02, and 2002-03 as well as those which had come to notice in earlier years but could not be dealt with in previous years.

We list below some of the anomalies, discrepancies, irregularities noticed by the Auditors in the utilisation of funds, implementation of schemes, programmes etc. by the different departments of the Uttar Pradesh Government during the last three years starting from 2000-01.

4.2 Accelerated Irrigation Benefit Programme

Government of India launched (in 1996-97) the Accelerated Irrigation Benefit Programme (AIBP) for achievement of targeted irrigation potential of such projects where substantial investments were made and physical progress achieved but which had not been completed due to financial constraints faced by the States. In Uttar Pradesh 13 projects received funds under the AIBP in the form of Central Loan Assistance. As per the audit findings 4 of the 13 projects in UP, which received funds under AIBP did not fulfil the criteria to be included under AIBP. Large funds were injudiciously spent on a project in 2002-03, which was stopped in 1992 due to silting of the river. Funds from some of these projects were diverted for construction of Museum and a Cultural Centre in Lucknow. One of the project was treated as complete after achievement of 57 percent of the targeted irrigation potential. Also, a couple of projects received substantial funds from NABARD in violation of the rules of Government of India.

4.3 Agricultural Department

The main objective of the department is to increase production of various crops, improving the living standards of the farmers and to increase job opportunities in the rural sector by implementing various schemes/programmes. A review of the working of the department revealed failures in financial management resulting in large savings remaining un-surrendered, deficiencies in implementing schemes leading to non-fulfilment of targets. Consequently, the production of food grains, area under cultivation and the productivity remained static during the last three years. Some of the points worth attention are:

- Budgetary projections of the department were grossly unrealistic and inflated. Supplementary grants were obtained without assessing and ascertaining the actual requirements. Most of the funds received for Central and Centrally sponsored schemes remained unutilised and some of the funds were diverted to different uses.

- Centrally sponsored cotton development programme suffered due to inadequate distribution of breeder and certified seeds despite availability of funds. Even the area under cultivation declined considerably during 1997-98 – 2001-02. Implementation of many other programmes like Oilseed development programmes failed due to non-utilisation of available funds, inadequate training of farmers.

- State agricultural farms were not functioning properly and there were enormous shortages in production in these farms. Subsidies were released to suppliers of seeds without proper verification.

- Injudicious fixation of procurement price of seeds resulted in excess payment of seed supplying agencies.

- Manpower management was deficient resulting in excess employment in some cases and in some others a large number of posts remained vacant.

4.4 Implementation of Drugs and Cosmetic Act, 1940

The Act was enacted to combat production and marketing of spurious and not of standard quality drugs and cosmetics causing serious health hazards and even death to consumers. The auditors observed that the consumers were prone to risk of health hazards due to a number of reasons for which the UP Government could be held responsible. Monitoring and evaluation of the implementation of the provisions of the act was, by and large, non-existent. There was no regulatory authority to co-ordinate the efforts of the authorities. Rate of inspections of manufacturing facilities/sale points of allopathic medicines and sampling of these medicines from sellers was dismal. Considerable amount of funds released by the Central Government for strengthening the labs of Government Pharmacies remained unutilised.

4.5 Uttar Pradesh Health System Development Project

This is an externally aided project aimed at bringing about structural and qualitative changes in the health sector so as to transform it into a modern, responsive and accountable system to provide high quality, affordable and integrated health service. The audit scrutiny revealed that implementation of the project was unsatisfactory, the monitoring mechanism was not effective, and physical and financial progress in many critical areas was lagging behind the target. The utilisation of the available funds ranged between 11 – 73 percent of the targeted expenditure during 1999-2003. The physical progress of ten critical civil works dismal to this date and due to this the projects failed to achieve its social objectives. Computers, ambulance purchased was not put to use or was non-functional. Ineffectiveness of monitoring and evaluation system in the projects resulted in tardy physical and financial progress.

4.6 Scheme of Scholarships to SC/ST Students

A review of the scheme revealed a declining trend in the coverage of SC and ST students, increasing rate of drop outs and a declining in percentage of passed students due to improper planning, unrealistic budgeting, irregular allotments, financial mismanagement, improper identification of beneficiaries, deficient system of issue of sanction of scholarships, unfair distribution of scholarships, and lack of monitoring and evaluation.

4.7 Rural Housing Schemes

The aim of the Indira Awas Yojana was to help in the construction/up-gradation of dwelling units for the members of SC/ST rural poor below the poverty line by providing them grants. Review of implementation of the scheme revealed only 12 percent of the BPL families were covered in 5 years. Benefits of the scheme were allowed to ineligible families and non-SC/ST people were provided benefits in excess of the prescribed limit. Large dwellings were not provided with smokeless chullahs and sanitary latrines. The progress of the scheme was slow and monitoring was inadequate.

4.8 Chief Minister's Discretionary Fund

As per the provision in UP Chief Minister’s Discretionary Fund (CMDF) rules, 1999, grants are sanctioned to individuals who are eligible for assistance from state exchequer. They include helpless, disabled persons from weaker sections, destitute widows, children, poor persons suffering from diseases etc. Test check of transactions from CMDF revealed the breach of rules while providing assistance to those eligible.

4.9 Miscellaneous

- Losses were incurred due to injudiciously putting Government money in a non-scheduled bank.

- Payment of pay and allowances by the police department to the trainees against the orders of the Government resulted in considerable irregular expenditure.

- Non-adherence of milestones for completing projects as per agreements resulted in non-recovery of money from contractors.

- Avoidable, excess, and unfruitful expenditure by the UP Government and its various departments resulted in large sum of money being wasted, which could have been properly utilised by adequate planning and monitoring.

- Commencement of bridge work without ensuring availability of land, premature withdrawal and irregular retention of Government money unfruitful use and loss of money to the UP Government.

4.10 System of Internal Audit

It is an important tool available to the management for assessing the extent of accountability, compliance and efficiency prevailing in the organisation. The Government of Uttar Pradesh issued instructions for the formation of 'Internal Audit Organisation' in all its departments in 1988 and further orders were issued in 2001 to systemise the internal audit activities. The working of the internal audit system in two departments of the Government viz., Forest and Co-operative departments for the period 1998-2003 were reviewed to assess their efficiency and effectiveness. The review revealed the following:

- In Forest department, some of the positions of the auditors were lying vacant and there was no provision for training these audit staff. Roster of periodicity of Audit was not maintained to enable the internal audit to plan its activities systematically. The internal audit did not maintain records to show the number of units which had failed to respond to queries within one month and details of action taken in this regard were also not available on records. There was ineffective follow up of audit reports and the department was unable to furnish reports of special audits conducted, if any, during 1998-2002 and no special audit was carried out in 2002-03.

- As regards Co-operative department, the department till date could frame no internal audit manual. No audit planning was done nor risk indicators identified. No special audits were conducted by the internal audit cell.

The situation of Internal Audit System in these two departments was dismal despite instructions by the Government to strengthen the internal audit system.

In implementing budget decisions and allocations, lessons should be drawn from the past irregularities with a view to avoiding major lapses in future.

Chapter 5: Summary and Recommendations

In the case of Uttar Pradesh there is, in budgetary terms, a tendency for habitually overrunning voted appropriations with an undue reliance on supplementary demands and ex-post approvals. Individual departments are following the practice of making incremental demands for grants without much reference to the needs of their sectors or a recognition of the overall resource constraint. In a situation like this, the Department of Finance has to take a synoptic view and perform the role of a coordinator of individual spending claims. It is well known that a large part of expenditures are unable to reach targets. Budgetary reforms are a key to improving the effectiveness of government expenditures. Table 5.1 summarised the main difference in budgetary management according to different stages.

Table 5.1: Deficiencies in Budgetary Management

Deficiencies in Expenditure Management in India: A Summary	
Formulation Stage	Piecemeal approach, centralising – synoptic features weak; overstated demands; perceived soft-budget constraints.
Implementation Stage	Long decision-lags, expenditure bunching close to deadlines; excess of actual expenditure over budgeted amounts; poor coordination between intergovernmental units.
Approval (Legislative) Stage	Most demands for grants remain undiscussed; perfunctory approval; an overwhelming proportion of expenditure 'charged' on the CFI and not subject to voting.
Ex-Post Stage	Delayed evaluation (extremely long time-lags); loss of interest; poor follow-up of punitive aspects; poor corrective feedback.
Overall Perspective	Poor budgetary forecasting; systematic biases in predicting expenditure and revenue opacity in expenditure-related processes; built-in incentives for borrowing-based expenditures.

Budgetary reforms are critical to improving the efficiency of the state's fiscal intervention. The objective of budgetary reform should be to improve the outcomes in terms of the quality, extent and reach of publicly provided services by the State Government. We have reviewed the different stages of the budgetary process and outlined the inadequacies at each step. Accordingly, budgetary reforms should focus on the following aspects.

5.1 Framework of Remedial Measures

The suggested measures are listed below.

5.2 Aggregate Level

At the state level, procedural changes are required for strengthening the synoptic view of the budget, and effectively altering expenditure related choices down the stream. For this purpose:

i. A fiscal adjustment period (say, five years) should be announced during which the time profile of the fiscal-deficit target should be fixed (as stipulated in the UPFRBMA).

ii. Given the fiscal-deficit target and required annual correction, all adjustments should be made in the expenditure side of the budget in response to any short-term variations on the revenue side.

iii. Medium-to-long-term expenditure priorities should be fixed and, accordingly Department-wise ceilings on expenditure growth should be announced and communicated to each Departmental-head, before Department-wise budget exercises begin.

5.3 Outlook Changes

Expenditure agencies, *viz*., the administrative departments need to bring about a transformation in their outlook and values. In the maize of rules, regulations, and detailed legislation, and additional layers in the organisational and procedural structures, the real target of the expenditure, *viz*., the citizen for whom the services are meant is totally lost. Each Department should be asked to evaluate the quality of interface with people, in terms of such parameters as average length of queues, average waiting time, conditions of waiting, follow-up mechanism for complaints, and procedural formalities. The government may ask for higher user fees for better quality of service and differentiate service charges according to quality, urgency, etc.

5.4 Restoring the Budgetary Cycle

Although Uttar Pradesh has an elaborate document describing the budget cycle and the requirements from the different departments for submission of demands according to a prescribed time schedule, in practice, little reference is made to this document. It will help in better fiscal management if the provisions of the Uttar Pradesh Budget Manual are adhered to by the various departments.

5.5 Consistency Requirements

Although the state budget is only an annual financial statement, it should be formulated keeping in mind three consistency requirements.

i. consistency with the medium term fiscal framework,
ii. consistency with specified time targets, and
iii. consistency with macro and state level economic situation.

5.6 Capacity Building for Improving the Quality of Budgetary Predictions

Budget Estimates are basically predictions of actual outcomes. Much of the outcome depends on the economic and market conditions. For example, in a recession, revenues will fall, and in the expansionary phase revenues show a high buoyancy. Expenditure should also respond to prevailing inflationary conditions. Budget estimates are normally made with an incremental approach. This makes the quality of budget estimates as predictors of outcomes rather poor. There is a need for building up technical capacity for using modern forecasting methods with assimilation of all relevant information regarding the changes in the fiscal parameters due to state level and national level fiscal policy changes.

5.7 Presentational Aspects

Transparency is a critical attribute of efficient budgets. The more transparent is a budget, the more effective will be its impact. Certain additional statements given along with the budget will help provide more sound information to the legislators and to the public at large regarding the implications of the budget. It is suggested that the following additional schedules should be appended to the regular budget:

i. An estimate of explicit and implicit subsidies based on a clearly stated methodology,

ii. A separate schedule indicating major head-wise number of employees, and salaries and allowances should be presented in the budget along with proposed reforms,

iii. A separate schedule on pensions and terminal benefit outflows along with the number of pensioners. There should be an estimate of the likely pension bill for the next five years,

iv. A schedule of year-wise and project-wise outstanding guarantees (this has been initiated in UP), and

v. Statement on the deviations between actuals and budget estimates should be presented, and an analysis of factors explaining the deviation should be undertaken leading to continuous improvement in estimation methodology.

5.8 Computerisation of Budgetary Procedures

There is a need to link the Department of Finance with all the line departments and agencies for on-line compilation and collation of expenditures and revenues. This will help in identifying on a quarterly basis areas in which there is slackness. This will also help prepare the annual budget document more effectively.

5.9 Multi-Year Budgeting

Although the appropriations of a budget relate to only one year, expenditure cycles, particularly in the case of capital expenditures is normally more than one-year. It is important, therefore, to give approvals for expenditures for longer than one year period and developing mechanisms whereby sanctioned amounts in respect of selected projects do not lapse at the end of the financial year. This will also obviate the problem of using too many PL accounts on an *ad hoc* basis.

5.10 Stage-Wise Reforms

Some specific steps relevant to different budgetary stages are recommended below.

a. Budget Formulation

i. All departments should be supplied with robust forecasts of macroeconomic trends – relating to state level economic growth. These should be prepared by the Department of Finance. Government priorities should also be announced in advance.

ii. Budget ceilings should be announced for the forthcoming year well in advance. Accordingly, the departmental-heads can allocate the share to the sub-agencies and individual offices, who will adjust their budgets according to relevant ceilings.

b. Budget Approval

The legislature should allocate more time for discussing all demands. Such discussion should explore the quality and performance of past appropriations approved by the legislature.

c. Budget Implementation

i. Within the budget year, time-markers should be introduced. For example, expenditure targets for each quarter should be specified.

ii. Provide field officers with greater flexibility and incentive to achieve results.

iii. Cash-flow management should be completely computerised; the transmission and receipt of funds should be managed by state-of-the art information technology.

d. Budget Follow-Up

i. Audit follow-up is crucial for sound management. A framework should be developed to monitor the status of audit recommendations. In particular, audit comments need to be evaluated and a corrective plans need to be activated. Responsibility in the context of audit follow-up action should be clearly spelt out for agency/department/enterprise.

ii. Follow-up of recommendations of legislative committees entrusted with the task of examining the use of public funds is equally important.

5.11 Performance Budgeting for Ministries and Departments

Under a performance budget, governmental operations are divided into functions, programmes and activities/projects. A function refers to a major division of the work of the government such as education, health, and agriculture. Programmes refer to broad categories within a function that identify end-products or accomplishments in respect of the objectives of a function. Activities constitute the collection of homogenous types of work in a programme. Projects generally refer to activities that are of a capital nature. For example, education is considered a function, elementary education is considered a programme, and training of elementary teachers is taken as an activity. The construction of a school building is taken as a project.

The primary concern in a performance budget is to bring out the end-objectives associated with the monetary allocation in the budget. It relates the costs of providing a service and the results and accomplishments in financial as well as physical terms. The performance budget can thus serve in the role of an internal management tool. The Report of the Study Team on Financial Management (1967, p. 162) had listed the following objectives to be served by performance budgeting:

i. to correlate the physical and financial aspects of every programme on activity;

ii. to improve budget formulation, review and decision-making at all levels of management in the government machinery;

iii. to facilitate better appreciation and review by legislature;

iv. to measure progress towards long-term objectives as envisaged in the Plan; and

v. to bring annual budgets and development plans close together.

5.12 Budgeting Reforms: Specific Steps

Uttar Pradesh should undertake budgeting reforms with a view to imparting greater transparency and control. Important elements of budgeting reforms should include the following:

i. There is need to formulate a medium term fiscal policy. This may be done in the context of the UP's FRBMA. This medium term policy should be presented to legislature along with the budget, as required by the FRBMA. The annual budget should reflect the medium term priorities and objectives.

ii. A separate schedule indicating major head-wise number of employees, and salaries and allowances should be presented in the budget along with proposed reforms.

iii. Separate schedule on pensions and terminal benefit outflows along with number of pensioners. There should be an estimate of the likely pension bill for the next five years.

iv. A major head-wise schedule of subsidies, making as many subsidies explicit as possible.

v. A schedule of year-wise and project-wise outstanding guarantees (this has been initiated in UP).

vi. Computerisation of budgeting methodology and procedures should be undertaken; and quarterly flows of receipts and expenditures also should be announced and monitored.

vii. Statement on the deviations between actuals and budget estimates should be presented, and an analysis of factors explaining the deviation should be undertaken leading to continuous improvement in estimation methodology.

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Uttar Pradesh

Table 3A.1

Own Tax Revenues			Rs.crore
	BE	RE	Actuals
1990-91	2699.7	2846.6	3162.1
1991-92	3171.8	3375.2	3497.4
1992-93	3665.1	3820.5	3886.3
1993-94	4472.1	4214.1	4132.0
1994-95	4601.2	4696.4	4878.3
1995-96	5155.5	5390.7	5468.9
1996-97	6069.7	6079.7	6306.0
1997-98	7075.9	7021.1	6998.0
1998-99	9369.5	8090.2	7910.1
1999-00	10456.8	9969.6	9400.9
2000-01	11482.0	10604.3	10980.0
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**-145.4**	**46.5**	**-191.9**
Avg(90/91-95/96)	**210.0**	**113.6**	**96.4**
Avg(96/97-00/01)	**-571.8**	**-34.0**	**-537.8**

Source(Basic Data):RBI Bulletin on State Finances

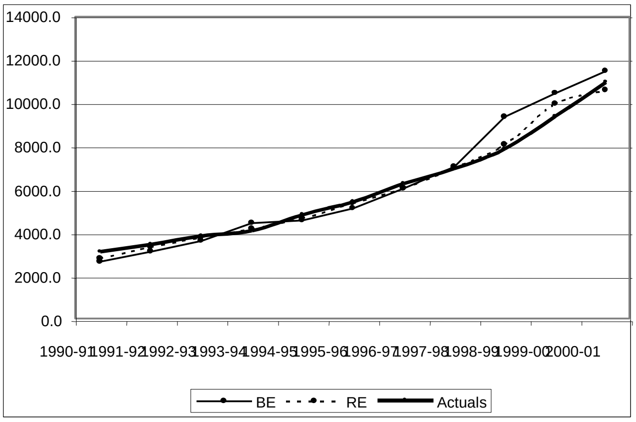

Chart 3A.1

Table 3A.2

Own Tax Revenues		**(% error)**	Rs.crore
	BE	RE	Actuals
1990-91	14.625	9.977	5.163
1991-92	9.308	3.493	6.026
1992-93	5.694	1.694	4.069
1993-94	-8.230	-1.988	-6.121
1994-95	5.680	3.729	2.026
1995-96	5.732	1.430	4.364
1996-97	3.748	3.589	0.164
1997-98	-1.114	-0.330	-0.781
1998-99	-18.450	-2.277	-15.813
1999-00	-11.232	-6.049	-4.887
2000-01	-4.572	3.422	-8.277
Average % error		(A-B/A)	0.108
(A-R)/A	1.517	(R-B)/R	-1.279

Source(Basic Data):RBI Bulletin on State Finances

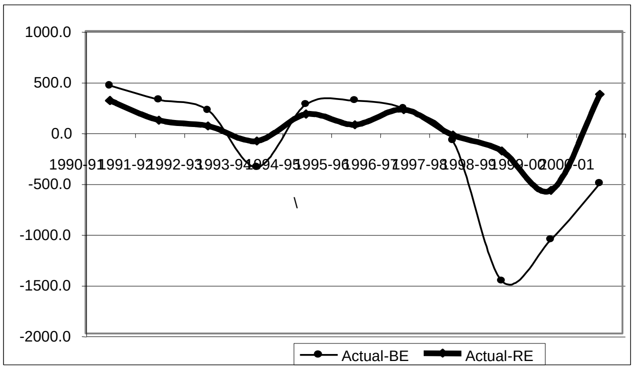

Chart 3A.2

Difference between Actual and BE and Actual and RE

Table 3A.3

Own Tax Revenues

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	-30.3	DC	19.2

Analysis of DP as predictor of DA	
RMSE	603.0
Theil IC	0.641
Decomposition of Theil IC	
Mean Proportion	13.48
Slope Proportion	60.81
Disturbance Proportion	25.71
Regression of et on et-1 where et=DA-DP for t	
Est. coefficient	0.501
t-statistic	1.744
R^2	0.276

Source(Basic Data):RBI Bulletin on State Finances

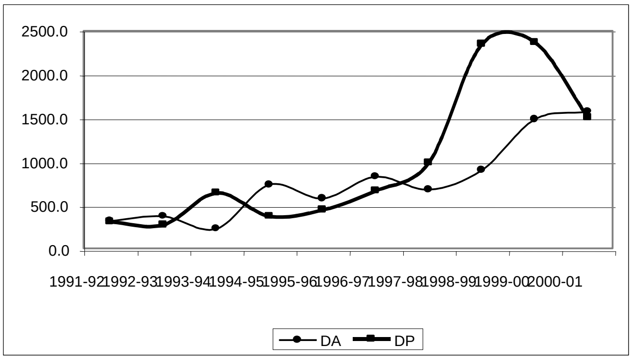

Chart 3A.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3B.1

Share in Central Taxes Rs.crore

	BE	RE	Actuals
1990-91	2288.4	2288.4	2305.7
1991-92	2505.0	2731.2	2731.4
1992-93	2934.4	3256.6	3398.6
1993-94	3591.5	3552.1	3552.1
1994-95	3883.2	3906.5	3959.8
1995-96	5120.7	5127.2	5034.0
1996-97	5864.9	5864.9	6072.4
1997-98	6464.7	6464.7	7114.9
1998-99	6235.6	6235.6	5771.1
1999-00	6859.1	7192.1	7478.9
2000-01	8344.6	10104.2	9045.5
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**215.7**	**-23.6**	**239.2**
Avg(90/91-95/96)	**109.7**	**19.9**	**89.8**
Avg(96/97-00/01)	**342.8**	**-75.7**	**418.5**

Source(Basic Data):RBI Bulletin on State Finances

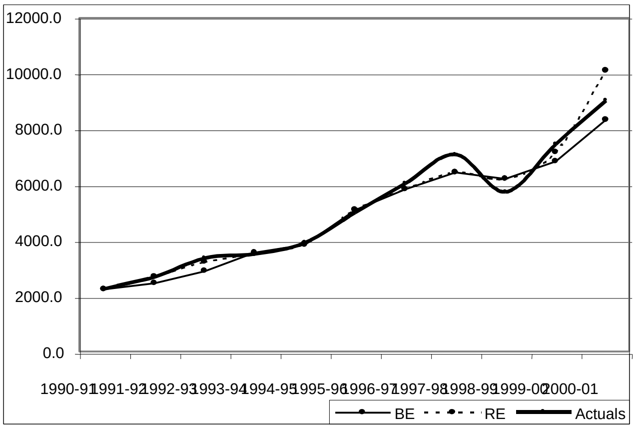

Chart 3B.1

Table 3B.2

Share in Central Taxes **(% error)** Rs.crore

	BE	RE	Actuals
1990-91	0.749	0.749	0.000
1991-92	8.287	0.005	8.282
1992-93	13.658	4.177	9.894
1993-94	-1.109	0.001	-1.110
1994-95	1.933	1.346	0.596
1995-96	-1.722	-1.851	0.127
1996-97	3.418	3.418	0.000
1997-98	9.138	9.138	0.000
1998-99	-8.048	-8.048	0.000
1999-00	8.287	3.835	4.629
2000-01	7.748	-11.704	17.414
Average % error		(A-B/A)	3.849
(A-R)/A	0.097	(R-B)/R	3.621

Source(Basic Data):RBI Bulletin on State Finances

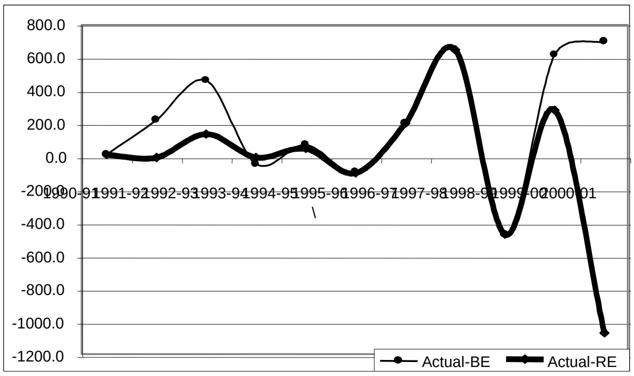

Chart 3B.2

Difference between Actual and BE and Actual and RE

Table 3B.3

Share in Central Taxes

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	25.1	DC	45.2

Analysis of DP as predictor of DA

RMSE	595.6
Theil IC	0.531

Decomposition of Theil IC

Mean Proportion	10.23
Slope Proportion	63.36
Disturbance Proportion	26.40

Regression of et on et-1 where et=DA-DP for t

Est. coefficient	0.507
t-statistic	4.285
R^2	0.696

Source(Basic Data):RBI Bulletin on State Finances

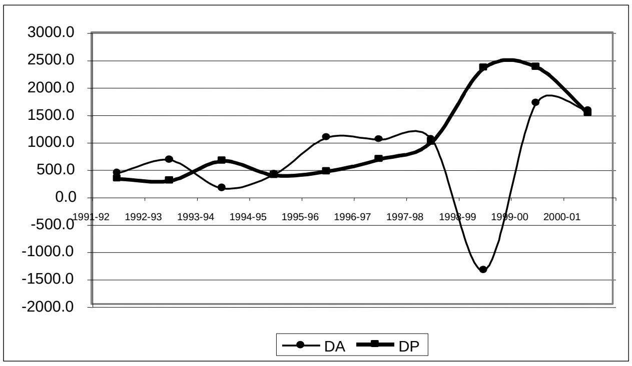

Chart 3B.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3C.1

Own Non-Tax Revenues			Rs.crore
	BE	RE	Actuals
1990-91	803.0	817.7	777.5
1991-92	872.4	1102.6	1083.5
1992-93	1275.5	1290.9	1420.9
1993-94	1317.4	1609.0	1717.5
1994-95	1478.2	1771.6	1889.3
1995-96	1815.2	2217.8	2399.4
1996-97	1297.4	1297.5	1318.5
1997-98	1577.6	1266.5	1291.7
1998-99	2122.1	1354.1	1475.1
1999-00	1791.9	1964.6	2011.7
2000-01	1919.2	1791.2	1944.7
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**96.3**	**77.0**	**19.4**
Avg(90/91-95/96)	**287.7**	**79.8**	**208.0**
Avg(96/97-00/01)	**-133.3**	**73.6**	**-206.9**

Source(Basic Data):RBI Bulletin on State Finances

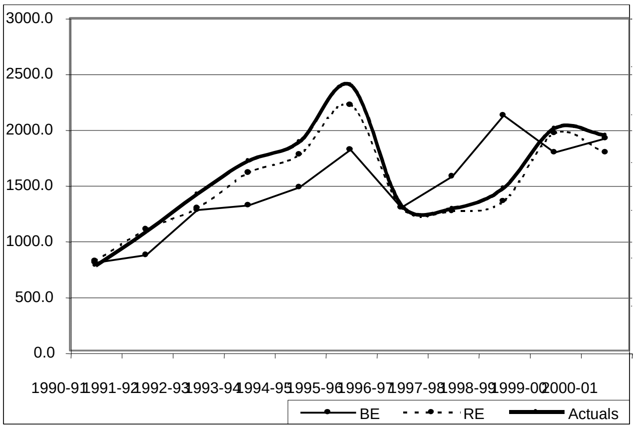

Chart 3C.1

Table 3C.2

Own Non-Tax Revenues		**(% error)**	Rs.crore
	BE	RE	Actuals
1990-91	-3.288	-5.171	1.790
1991-92	19.485	-1.761	20.879
1992-93	10.231	9.149	1.191
1993-94	23.295	6.319	18.122
1994-95	21.761	6.231	16.562
1995-96	24.346	7.571	18.149
1996-97	1.599	1.596	0.003
1997-98	-22.133	1.955	-24.568
1998-99	-43.862	8.200	-56.713
1999-00	10.927	2.344	8.789
2000-01	1.309	7.891	-7.147
Average % error		(A-B/A)	3.970
(A-R)/A	4.029	(R-B)/R	-0.268

Source(Basic Data):RBI Bulletin on State Finances

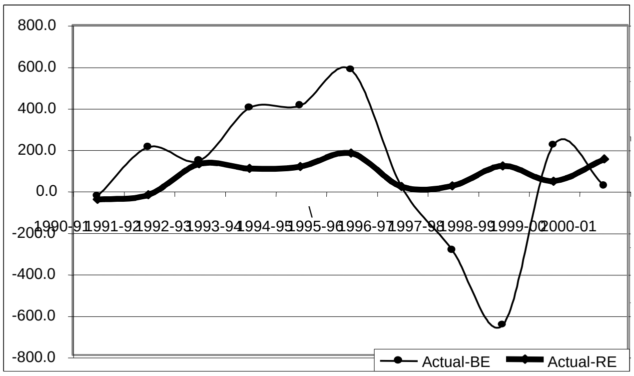

Chart 3C.2

Difference between Actual and BE and Actual and RE

Table 3C.3

Own Non-Tax Revenues			
Prediction Performance:Summary Statistics			
Prediction of Change			
Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)			
Benchmark is DC by applying 10 % to At-2			
Average % error			
DP	133.5	DC	192.2
Analysis of DP as predictor of DA			
RMSE	342.3		
Theil IC	0.712		
Decomposition of Theil IC			
Mean Proportion		-0.12	
Slope Proportion		-155.49	
Disturbance Proportion		255.61	
Regression of et on et-1 where et=DA-DP for t			
Est. coefficient		0.474	
t-statistic		1.731	
R^2		0.272	

Source(Basic Data):RBI Bulletin on State Finances

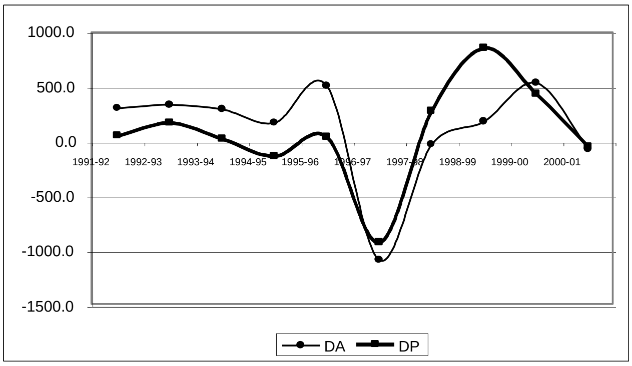

Chart 3C.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3D.1

Plan Revenue Expenditure Rs.crore

	BE	RE	Actuals
1990-91	2267.0	2391.5	2117.3
1991-92	2082.8	2268.5	1977.0
1992-93	2203.5	2360.7	2196.8
1993-94	2380.1	2568.2	2285.7
1994-95	2593.8	2763.5	2763.5
1995-96	3205.2	3494.9	2524.4
1996-97	4061.7	4322.0	3267.9
1997-98	4954.0	4612.4	3262.6
1998-99	4872.1	4463.0	3589.8
1999-00	4599.5	5142.9	4090.4
2000-01	5431.3	5258.5	3686.0
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**-626.3**	**-716.8**	**90.5**
Avg(90/91-95/96)	**-144.6**	**-330.4**	**185.8**
Avg(96/97-00/01)	**-1204.3**	**-1180.4**	**-23.9**

Source(Basic Data):RBI Bulletin on State Finances

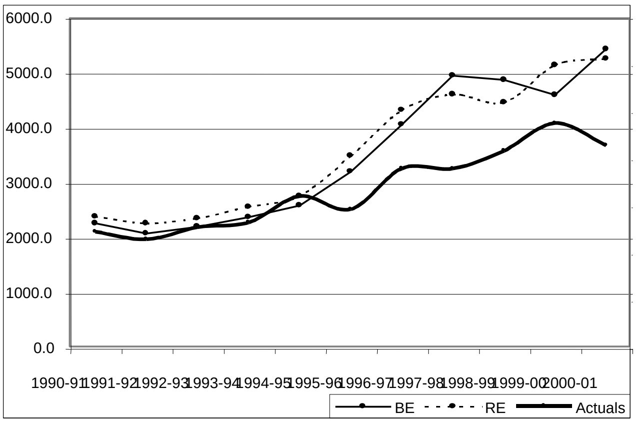

Chart 3D.1

Table 3D.2

Plan Revenue Expenditure **(% error)** Rs.crore

	BE	RE	Actuals
1990-91	-7.072	-12.948	5.203
1991-92	-5.351	-14.744	8.186
1992-93	-0.306	-7.459	6.657
1993-94	-4.128	-12.359	7.326
1994-95	6.142	0.000	6.142
1995-96	-26.965	-38.444	8.291
1996-97	-24.288	-32.255	6.024
1997-98	-51.841	-41.372	-7.405
1998-99	-35.720	-24.324	-9.166
1999-00	-12.446	-25.732	10.567
2000-01	-47.348	-42.660	-3.287
Average % error		(A-B/A)	-19.029
(A-R)/A	-22.936	(R-B)/R	3.503

Source(Basic Data):RBI Bulletin on State Finances

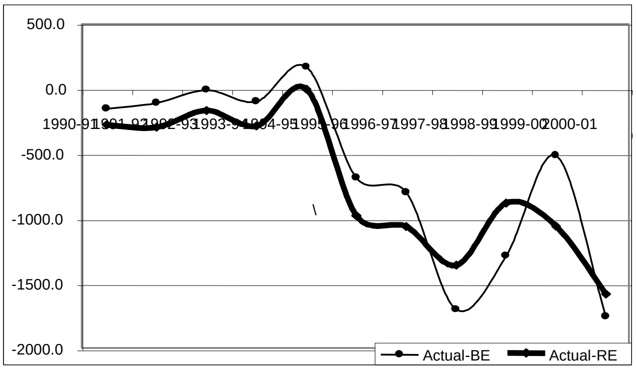

Chart 3D.2

Difference between Actual and BE and Actual and RE

Table 3D.3

Plan Revenue Expenditure

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	1273.5	DC	595.0

Analysis of DP as predictor of DA

RMSE	451.7
Theil IC	1.131

Decomposition of Theil IC

Mean Proportion	-0.20
Slope Proportion	-287.46
Disturbance Proportion	387.66

Regression of et on et-1 where et=DA-DP for t

Est. coefficient	0.549
t-statistic	5.047
R^2	0.760

Source(Basic Data):RBI Bulletin on State Finances

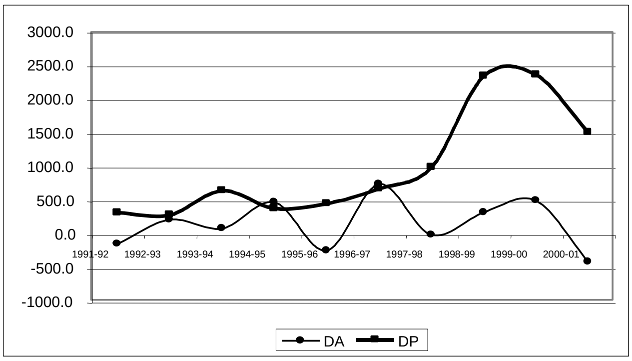

Chart 3D.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3E.1

Non-Plan Revenue Expenditure Rs.crore

	BE	RE	Actuals
1990-91	7421.2	7029.6	7421.1
1991-92	8218.8	8197.6	8422.2
1992-93	9199.2	9403.1	10493.9
1993-94	10792.7	11174.9	10994.4
1994-95	12269.4	12660.1	12660.1
1995-96	14835.8	15215.8	15031.4
1996-97	16795.4	16381.4	15939.8
1997-98	20774.4	20484.1	18932.4
1998-99	22701.4	23002.9	22485.1
1999-00	25162.4	25425.5	24657.3
2000-01	27492.5	28184.0	27346.6
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**-116.3**	**-252.3**	**136.0**
Avg(90/91-95/96)	**381.0**	**223.7**	**157.3**
Avg(96/97-00/01)	**-713.0**	**-823.4**	**110.4**

Source(Basic Data):RBI Bulletin on State Finances

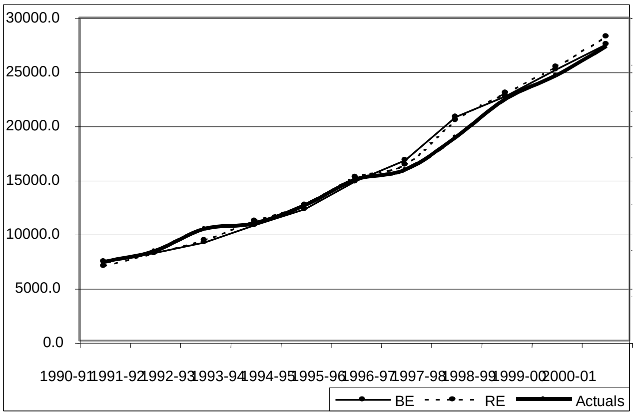

Chart 3E.1

Table 3E.2

Non-Plan Revenue Expenditure(% error) Rs.crore

	BE	RE	Actuals
1990-91	-0.001	5.275	-5.570
1991-92	2.415	2.667	-0.258
1992-93	12.338	10.395	2.169
1993-94	1.834	-1.642	3.420
1994-95	3.086	0.000	3.086
1995-96	1.301	-1.227	2.497
1996-97	-5.368	-2.771	-2.527
1997-98	-9.729	-8.196	-1.417
1998-99	-0.962	-2.303	1.311
1999-00	-2.048	-3.116	1.035
2000-01	-0.534	-3.062	2.454
Average % error		(A-B/A)	0.212
(A-R)/A	-0.362	(R-B)/R	0.563

Source(Basic Data):RBI Bulletin on State Finances

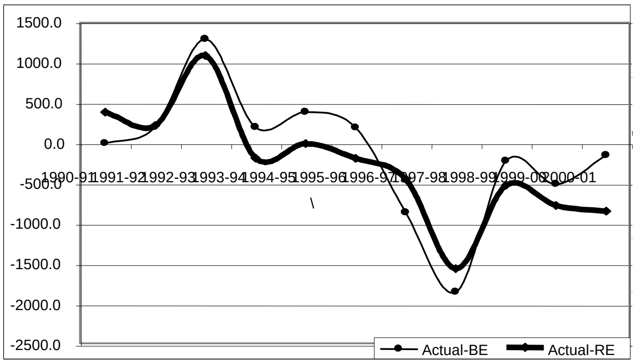

Chart 3E.2
Difference between Actual and BE and Actual and RE

Table 3E.3

Non-Plan Revenue Expenditure

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	-16.2	DC	13.5

Analysis of DP as predictor of DA

RMSE	876.7
Theil IC	0.378

Decomposition of Theil IC

Mean Proportion	-0.25
Slope Proportion	-43.01
Disturbance Proportion	143.27

Regression of et on et-1 where et=DA-DP for t

Est. coefficient	0.509
t-statistic	4.327
R^2	0.701

Source(Basic Data):RBI Bulletin on State Finances

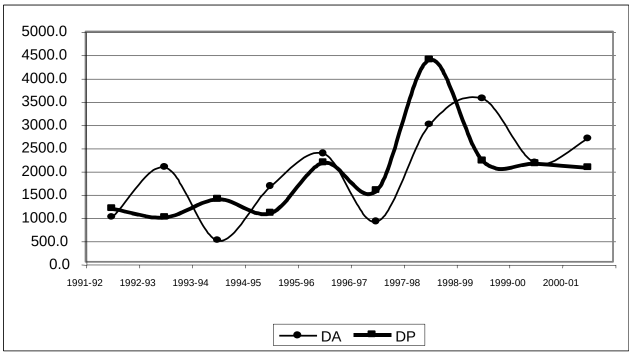

Chart 3E.3 Comparison of Prediction of Changes
DA:Difference of actual of current year from that of previous year
DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3F.1

Interest Payments			Rs.crore
	BE	RE	Actuals
1990-91	1320.7	1262.9	1278.9
1991-92	1687.7	1736.0	1710.3
1992-93	2083.4	2134.8	2041.6
1993-94	2503.5	2499.7	2111.1
1994-95	2930.5	2876.9	3217.4
1995-96	3837.9	3827.2	3324.9
1996-97	4115.1	4121.2	4061.0
1997-98	4805.8	4766.1	5331.2
1998-99	6019.2	6310.0	5516.6
1999-00	6504.7	6749.5	6553.1
2000-01	7763.0	8402.2	7455.4
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**-88.2**	**-189.5**	**101.3**
Avg(90/91-95/96)	**-113.2**	**-108.8**	**-4.4**
Avg(96/97-00/01)	**-58.1**	**-286.3**	**228.2**

Source(Basic Data):RBI Bulletin on State Finances

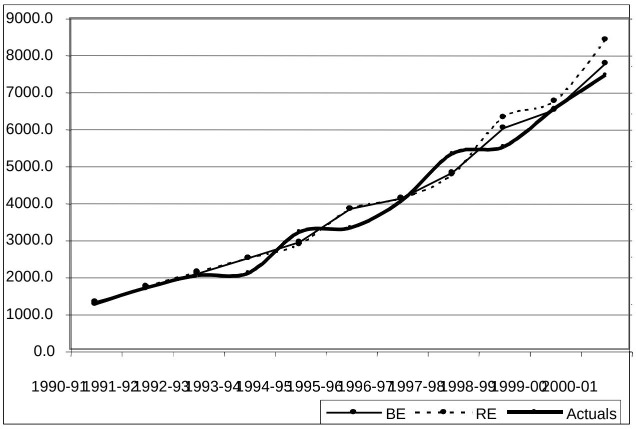

Chart 3F.1

Table 3F.2

Interest Payments		**(% error)**	Rs.crore
	BE	RE	Actuals
1990-91	-3.268	1.253	-4.579
1991-92	1.326	-1.501	2.786
1992-93	-2.048	-4.564	2.405
1993-94	-18.587	-18.405	-0.154
1994-95	8.918	10.586	-1.865
1995-96	-15.431	-15.107	-0.281
1996-97	-1.332	-1.481	0.147
1997-98	9.856	10.600	-0.832
1998-99	-9.111	-14.381	4.608
1999-00	0.738	-2.997	3.627
2000-01	-4.126	-12.700	7.608
Average % error		(A-B/A)	-3.006
(A-R)/A	-4.427	(R-B)/R	1.225

Source(Basic Data):RBI Bulletin on State Finances

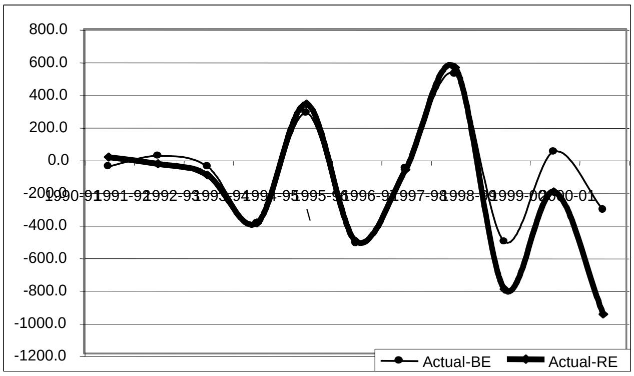

Chart 3F.2

Difference between Actual and BE and Actual and RE

Table 3F.3

Interest Payments

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	-156.7	DC	-2.1

Analysis of DP as predictor of DA

RMSE	639.4
Theil IC	0.810

Decomposition of Theil IC

Mean Proportion	0.17
Slope Proportion	26.82
Disturbance Proportion	73.01

Regression of et on et-1 where et=DA-DP for t

Est. coefficient	0.500
t-statistic	6.533
R^2	0.842

Source(Basic Data):RBI Bulletin on State Finances

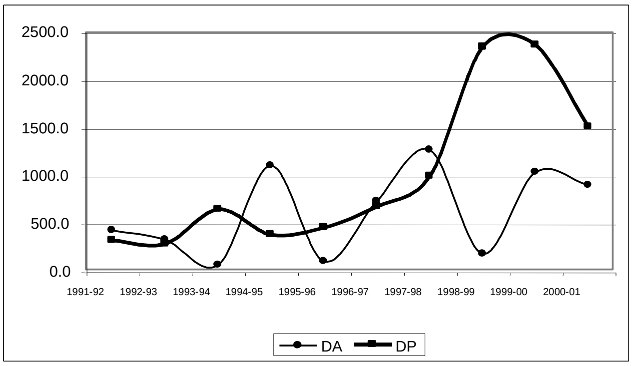

Chart 3F.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3G.1

Capital Receipts Rs.crore

	BE	RE	Actuals
1990-91	4020.6	4327.5	3884.4
1991-92	4280.2	3915.3	3896.1
1992-93	4220.5	4228.0	4678.3
1993-94	4580.1	4686.1	3541.7
1994-95	4912.5	5761.8	8796.1
1995-96	6809.2	6606.6	6386.4
1996-97	7597.2	8050.8	7016.6
1997-98	10419.7	10684.0	8357.3
1998-99	11301.4	12838.9	12655.3
1999-00	12474.0	14351.1	11573.7
2000-01	13755.8	16374.4	14076.0
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**44.6**	**-633.0**	**677.6**
Avg(90/91-95/96)	**393.3**	**276.3**	**117.0**
Avg(96/97-00/01)	**-373.9**	**-1724.1**	**1350.2**

Source(Basic Data):RBI Bulletin on State Finances

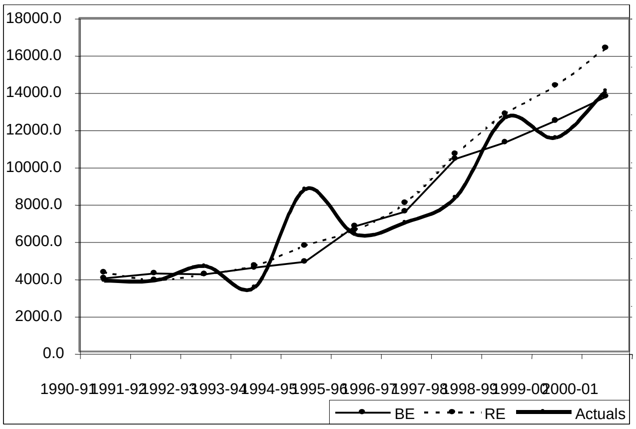

Chart 3G.1

Table 3G.2

Capital Receipts **(% error)** Rs.crore

	BE	RE	Actuals
1990-91	-3.506	-11.407	7.092
1991-92	-9.860	-0.494	-9.319
1992-93	9.786	9.624	0.179
1993-94	-29.317	-32.310	2.262
1994-95	44.151	34.496	14.740
1995-96	-6.621	-3.447	-3.068
1996-97	-8.274	-14.739	5.634
1997-98	-24.679	-27.841	2.473
1998-99	10.698	-1.450	11.975
1999-00	-7.779	-23.997	13.080
2000-01	2.274	-16.329	15.992
Average % error		(A-B/A)	-2.102
(A-R)/A	-7.990	(R-B)/R	5.549

Source(Basic Data):RBI Bulletin on State Finances

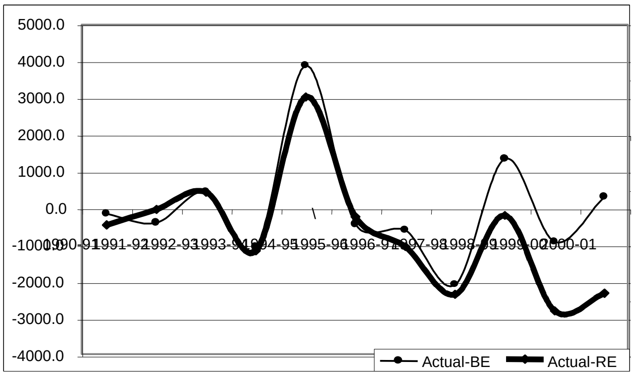

Chart 3G.2

Difference between Actual and BE and Actual and RE

Table 3G.3

Capital Receipts

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	107.8	DC	-253.4

Analysis of DP as predictor of DA

RMSE	2677.5
Theil IC	1.009

Decomposition of Theil IC

Mean Proportion	3.78
Slope Proportion	17.96
Disturbance Proportion	78.26

Regression of et on et-1 where et=DA-DP for t

Est. coefficient	0.526
t-statistic	5.487
R^2	0.790

Source(Basic Data):RBI Bulletin on State Finances

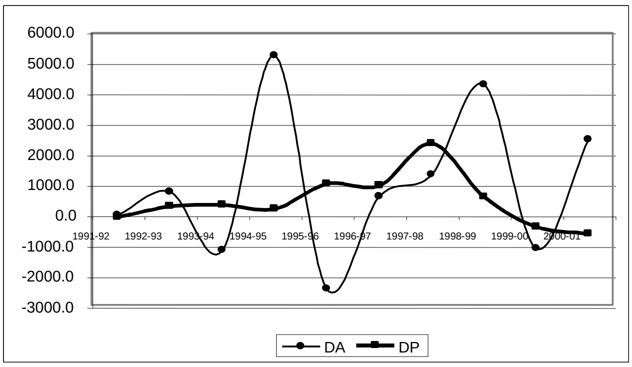

Chart 3G.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3H.1

Capital Expenditure			Rs.crore
	BE	RE	Actuals
1990-91	2491.1	2879.1	2701.8
1991-92	3026.9	3041.5	2846.9
1992-93	2757.6	3497.6	3444.6
1993-94	3338.7	3555.0	2995.2
1994-95	3159.1	3490.5	4920.3
1995-96	4910.6	4169.8	3231.2
1996-97	4382.8	4696.4	3809.0
1997-98	4673.3	5059.2	4430.5
1998-99	5467.1	5486.2	5387.5
1999-00	5922.2	6478.1	5867.6
2000-01	8380.3	9098.4	5648.6
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**-293.3**	**-560.8**	**267.5**
Avg(90/91-95/96)	**76.0**	**-82.2**	**158.3**
Avg(96/97-00/01)	**-736.5**	**-1135.0**	**398.5**

Source(Basic Data):RBI Bulletin on State Finances

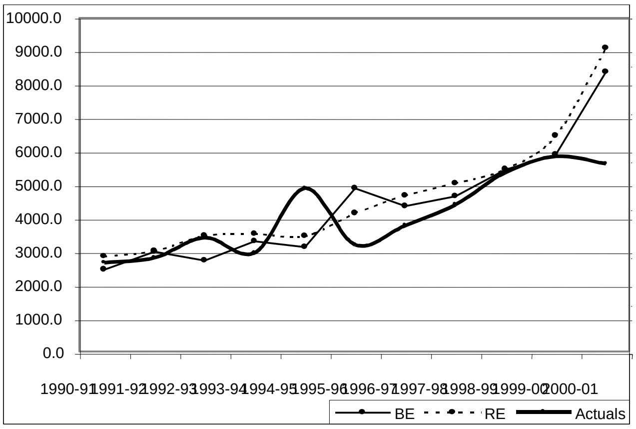

Chart 3H.1

Table 3H.2

Capital Expenditure		**(% error)**	Rs.crore
	BE	RE	Actuals
1990-91	7.797	-6.563	13.476
1991-92	-6.322	-6.833	0.479
1992-93	19.945	-1.538	21.158
1993-94	-11.468	-18.691	6.086
1994-95	35.795	29.059	9.495
1995-96	-51.976	-29.049	-17.767
1996-97	-15.064	-23.296	6.677
1997-98	-5.480	-14.191	7.628
1998-99	-1.478	-1.831	0.347
1999-00	-0.930	-10.405	8.582
2000-01	-48.360	-61.074	7.893
Average % error		(A-B/A)	-7.049
(A-R)/A	-13.128	(R-B)/R	5.823

Source(Basic Data):RBI Bulletin on State Finances

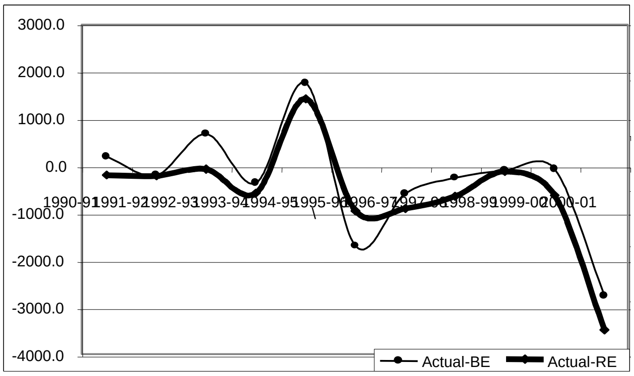

Chart 3H.2
Difference between Actual and BE and Actual and RE

Table 3H.3

Capital Expenditure

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	171.7	DC	80.8
Analysis of DP as predictor of DA			
RMSE	1537.2		
Theil IC	1.533		
Decomposition of Theil IC			
Mean Proportion		0.31	
Slope Proportion		46.55	
Disturbance Proportion		53.14	
Regression of et on et-1 where et=DA-DP for t			
Est. coefficient		0.540	
t-statistic		5.034	
R^2		0.759	

Source(Basic Data):RBI Bulletin on State Finances

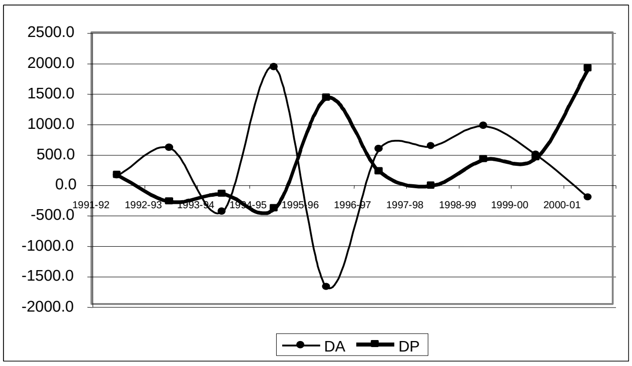

Chart 3H.3 Comparison of Prediction of Changes
DA:Difference of actual of current year from that of previous year
DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3I.1

Revenue Deficit Rs.crore

	BE	RE	Actuals
1990-91	1676.5	2237.4	1228.3
1991-92	1487.4	935.9	724.6
1992-93	1356.7	923.2	1014.6
1993-94	1235.6	1636.3	1148.7
1994-95	1971.8	2052.4	2030.4
1995-96	3129.2	2748.9	2340.7
1996-97	4879.0	4646.1	3179.1
1997-98	7696.3	7618.4	4623.9
1998-99	7093.8	8665.9	8696.2
1999-00	6930.8	7923.0	7252.6
2000-01	5885.2	5818.6	6289.3
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**-437.6**	**-607.1**	**169.4**
Avg(90/91-95/96)	**-395.0**	**-341.1**	**-53.8**
Avg(96/97-00/01)	**-488.8**	**-926.2**	**437.4**

Source(Basic Data):RBI Bulletin on State Finances

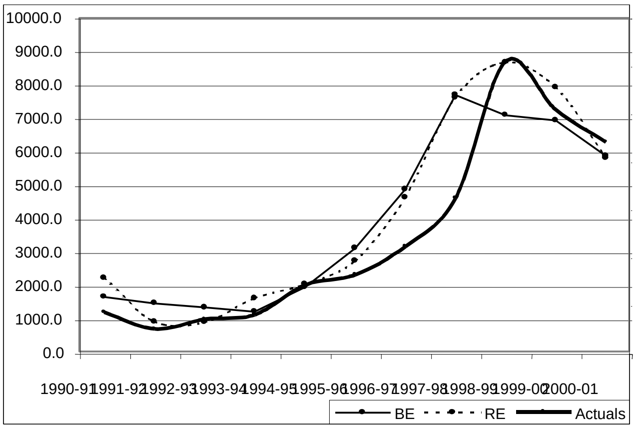

Chart 3I.1

Table 3I.2

Revenue Deficit **(% error)** Rs.crore

	BE	RE	Actuals
1990-91	-36.491	-82.158	25.070
1991-92	-105.276	-29.167	-58.923
1992-93	-33.724	9.003	-46.954
1993-94	-7.565	-42.449	24.489
1994-95	2.889	-1.080	3.926
1995-96	-33.687	-17.440	-13.834
1996-97	-53.470	-46.144	-5.013
1997-98	-66.446	-64.761	-1.023
1998-99	18.427	0.348	18.142
1999-00	4.437	-9.243	12.523
2000-01	6.426	7.484	-1.144
Average % error		(A-B/A)	-27.680
(A-R)/A	-25.055	(R-B)/R	-3.886

Source(Basic Data):RBI Bulletin on State Finances

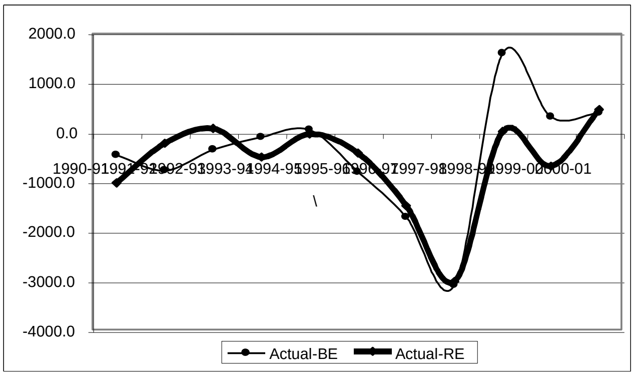

Chart 3I.2

Difference between Actual and BE and Actual and RE

Table 3I.3

Revenue Deficit

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	-69.6	DC	94.6
Analysis of DP as predictor of DA			
RMSE	1751.6		
Theil IC	1.081		
Decomposition of Theil IC			
Mean Proportion		3.00	
Slope Proportion		27.94	
Disturbance Proportion		69.06	
Regression of et on et-1 where et=DA-DP for t			
Est. coefficient		0.509	
t-statistic		3.242	
R^2		0.568	

Source(Basic Data):RBI Bulletin on State Finances

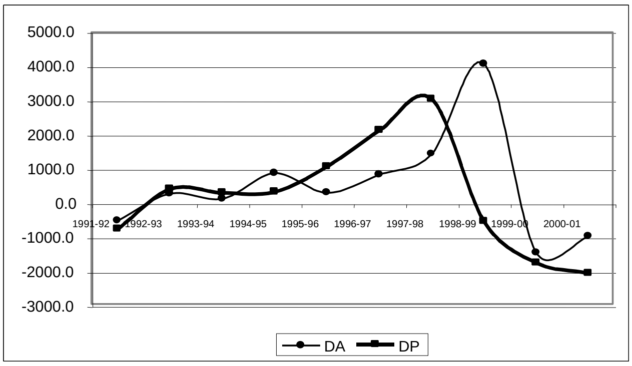

Chart 3I.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3J.1

Fiscal Deficit Rs.crore

	BE	RE	Actuals
1990-91	3558.6	4396.3	3067.6
1991-92	3765.2	3356.6	2836.6
1992-93	3401.3	3569.2	3710.9
1993-94	3689.2	4202.0	3165.8
1994-95	4226.7	4602.3	4048.6
1995-96	5339.2	5507.8	4380.6
1996-97	8103.3	8179.0	5956.2
1997-98	11024.0	11312.6	7576.0
1998-99	10706.5	12091.4	11632.5
1999-00	10951.1	12256.3	11098.7
2000-01	12358.0	12279.2	10179.5
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**-860.9**	**-1281.8**	**420.9**
Avg(90/91-95/96)	**-461.7**	**-737.4**	**275.7**
Avg(96/97-00/01)	**-1340.0**	**-1935.1**	**595.1**

Source(Basic Data):RBI Bulletin on State Finances

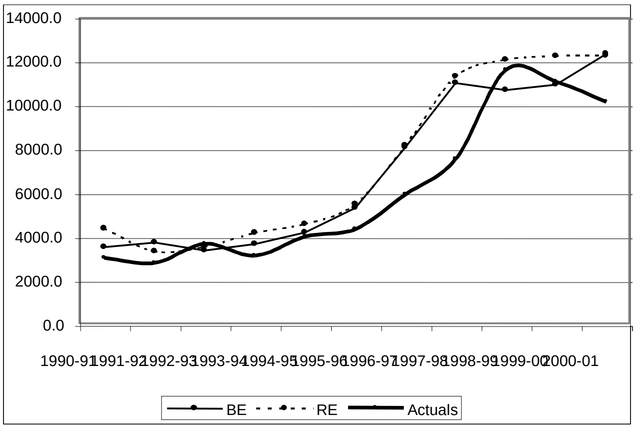

Chart 3J.1

Table 3J.2

Fiscal Deficit **(% error)** Rs.crore

	BE	RE	Actuals
1990-91	-16.007	-43.315	19.055
1991-92	-32.735	-18.332	-12.172
1992-93	8.345	3.818	4.706
1993-94	-16.533	-32.734	12.206
1994-95	-4.400	-13.676	8.161
1995-96	-21.883	-25.731	3.060
1996-97	-36.049	-37.319	0.925
1997-98	-45.513	-49.322	2.551
1998-99	7.961	-3.945	11.454
1999-00	1.330	-10.430	10.649
2000-01	-21.400	-20.626	-0.641
Average % error		(A-B/A)	-16.080
(A-R)/A	-22.874	(R-B)/R	5.450

Source(Basic Data):RBI Bulletin on State Finances

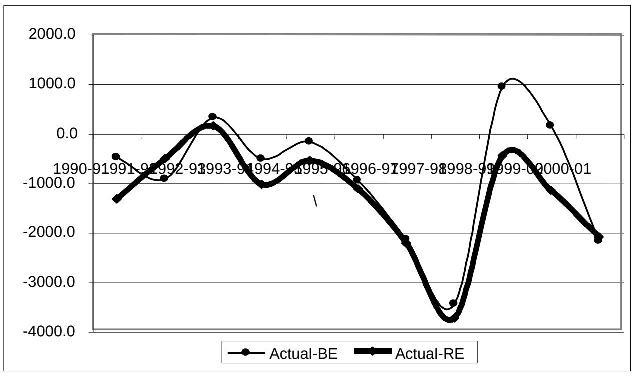

Chart 3J.2

Difference between Actual and BE and Actual and RE

Table 3J.3

Fiscal Deficit

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	-0.9	DC	122.1

Analysis of DP as predictor of DA

RMSE	1760.2
Theil IC	1.063

Decomposition of Theil IC

Mean Proportion	3.05
Slope Proportion	29.18
Disturbance Proportion	67.78

Regression of et on et-1 where et=DA-DP for t

Est. coefficient	0.507
t-statistic	3.202
R^2	0.562

Source(Basic Data):RBI Bulletin on State Finances

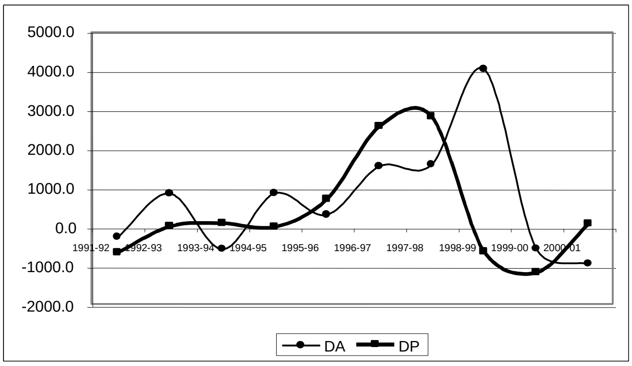

Chart 3J.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Uttar Pradesh

Table 3K.1

Primary Deficit Rs.crore

	BE	RE	Actuals
1990-91	2237.9	3133.4	1788.7
1991-92	2077.5	1620.6	1126.3
1992-93	1317.9	1434.5	1669.4
1993-94	1185.6	1702.4	1054.6
1994-95	1296.2	1725.4	831.1
1995-96	1501.3	1680.6	1055.7
1996-97	3988.2	4057.8	1895.2
1997-98	6218.2	6546.5	2244.8
1998-99	4687.2	5781.5	6115.9
1999-00	4446.4	5506.8	4545.7
2000-01	4595.0	3877.0	2724.2
Average Error	Abar-Bbar	Abar-Rbar	Rbar-Bbar
Avg(90/91-00/01)	**-772.7**	**-1092.3**	**319.5**
Avg(90/91-95/96)	**-348.4**	**-628.5**	**280.1**
Avg(96/97-00/01)	**-1281.9**	**-1648.8**	**366.9**

Source(Basic Data):RBI Bulletin on State Finances

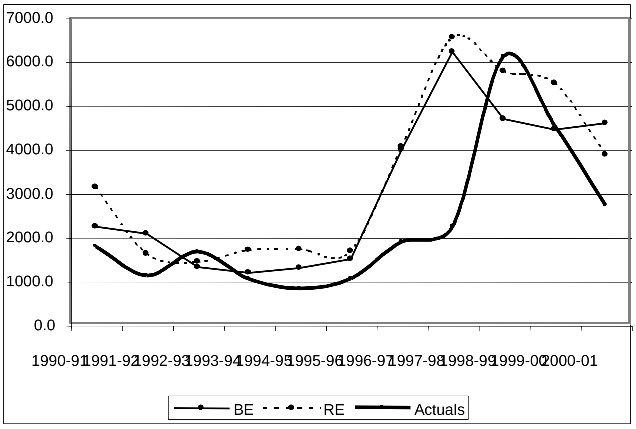

Chart 3K.1

Table 3K.2

Primary Deficit **(% error)** Rs.crore

	BE	RE	Actuals
1990-91	-25.115	-75.181	28.579
1991-92	-84.461	-43.891	-28.195
1992-93	21.055	14.070	8.129
1993-94	-12.421	-61.417	30.354
1994-95	-55.955	-107.599	24.877
1995-96	-42.204	-59.187	10.669
1996-97	-110.441	-114.113	1.715
1997-98	-177.010	-191.633	5.014
1998-99	23.360	5.468	18.927
1999-00	2.184	-21.144	19.256
2000-01	-68.675	-42.318	-18.519
Average % error		(A-B/A)	-48.153
(A-R)/A	-63.359	(R-B)/R	9.164

Source(Basic Data):RBI Bulletin on State Finances

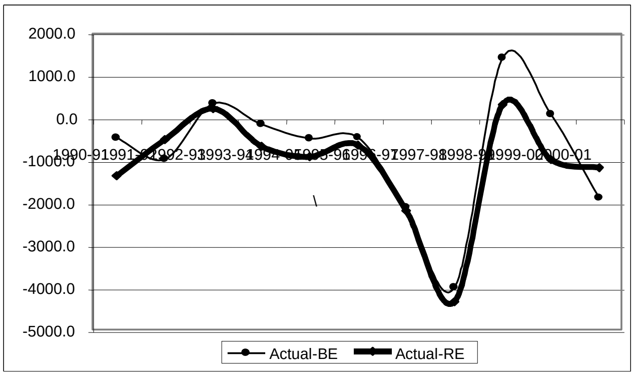

Chart 3K.2

Difference between Actual and BE and Actual and RE

Table 3K.3

Primary Deficit

Prediction Performance:Summary Statistics

Prediction of Change

Change in actuals DA =(At-At-1) predicted by DP=(Bt-Rt-1)

Benchmark is DC by applying 10 % to At-2

Average % error

DP	-20.6	DC	104.5
Analysis of DP as predictor of DA			
RMSE	2118.5		
Theil IC	1.331		
Decomposition of Theil IC			
Mean Proportion		2.97	
Slope Proportion		19.04	
Disturbance Proportion		77.99	
Regression of et on et-1 where et=DA-DP for t			
Est. coefficient		0.503	
t-statistic		3.627	
R^2		0.622	

Source(Basic Data):RBI Bulletin on State Finances

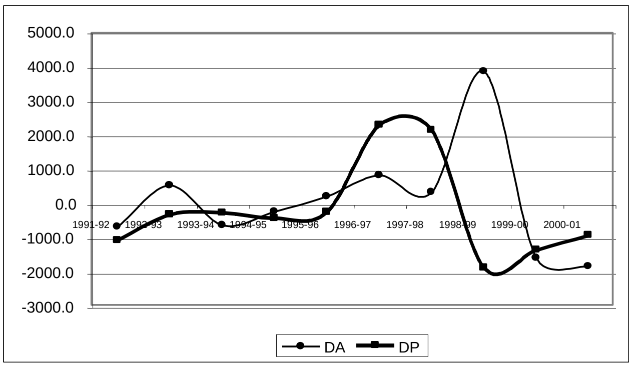

Chart 3K.3 Comparison of Prediction of Changes

DA:Difference of actual of current year from that of previous year

DP:Difference from BE of current year from RE of pevious year

Annexure 1: Preparation of Departmental Budget Estimates for the Financial Year 2005-06

Under Article 202 of the Constitution of India, it is mandatory that in any financial year statements containing estimates of receipts and expenditure should be laid in the legislature. This annual finance statement is known as the budget.

Uttar Pradesh manual lays down the rules and regulations for the preparation of the budget documents to be followed by the officials and the government departments.

Responsibilities of the Department for Deciding the Estimates

The Estimates should be complete and correct. The Estimating Officer should keep in mind that while making provisions for additional expenditure (which could be avoided or saved) would be considered as financial irregularities, same as in the case of spending more than the sanctioned (approved) fund. Sometimes, it would have serious consequences and if the officers are found guilty would be held responsible personally.

The required information should be sent to the Finance Department in the stipulated time period. In the absence of this information, the Finance Department would finalise the estimates on its own. In such cases if any mistake remains, then the responsibilities would be of the officers of concerned Administrative Department.

The Finance Department if it feels necessary, can send the departmental estimates to the concerned Secretary of Administrative Department for information or for clarification of the doubtful question. But, it is clear that the Finance Department is not under any obligation to do so. Therefore, it is the duty of the Estimating Officer to scrutinise the information carefully before sending it to the Finance Department.

Uttar Pradesh Fiscal Responsibility and Budget Management Act

In this Act the Fiscal Principles have been laid down. Therefore, it is important that the assessment of estimates of receipts and expenditure should be close to the actuals. It is suggested that for the year 2005-06, that in the Income Expenditure Statement, the estimates of receipts and expenditure should be done carefully.

Receipts Estimates

It is the responsibility of the Administrative Department that estimates relating to the revenue receipts should be sent to Finance Department latest by 30 November, 2004.

Expenditure Estimates

In addition to other points, an important point to be noted is that in the expenditure estimates, while preparing the estimates of salaries, DA, etc., only filled up posts (working posts) should be used as base in place of sanctioned posts.

Protected Funds

There is less transparency in most of the reserved/funds. Correct figures of expenditure are not presented and there is less control of legislative assembly on these funds. The creation of these funds do not yield the expected benefits. Most of the funds are such that they can be abolished and alternative arrangements can be made.

The Eleventh Finance Commission (EFC) in its recommendation has stated that due to creation of different funds there would be increase of non-transparency in the budgetary process.

In this context, it is mentioned that it would be the responsibility of Administrative Department to send the estimates of expenditure to Finance Department latest by 30 November, 2004.

New Heads of Expenditure

The proposals of new demands should be examined on the basis of criteria decided for such examination. The responsibility of the decision/allocation of the expenditure under the Plan head lies with the Employment/Social Welfare Department, therefore, in the budget, it is necessary that before making the provisions under these heads, the expectations of the concerned department should be known.

Though, the last date of sending the proposals of new demands to the Finance Department is decided as 30 November, 2004, but the proposals related to the new expenditure should be presented immediately as and when they become ready and need not wait for the last date for presentation. This would give sufficient time to the Finance Department and the Administrative Department of the Secretariat to scrutinise the estimates and also call for any additional information if required. The proposals received by the Finance Department after the expiry of decided date, would generally not be considered. Therefore, the responsibility of any inconvenience to the public service would be that of concerned officer of the concerned Department, who has not taken action in time.

Important Direction for Budget Preparation

In addition to other points, while preparing the budget for any financial year, it is important to ensure the expenditure estimates should be classified as per the prescribed standard heads.

The proposals in the budget for the year 2005-06, for the central plan schemes and central revised schemes, should be made under the major heads 01 to 50 and 51 to 97. Also the central share (in percent) should be shown under the different schemes.

The information regarding the Gazetted Officer and non-Gazetted Officer is published in volume 6 of the Budget. Therefore, it is expected from the each Department that they should send the detailed position regarding the total number of permanent and temporary Gazetted and non-Gazetted officers and their pay scales in the prescribed format to the Financial Resources (Central Assistance) Division of the Finance Department, latest by 30 November, 2004 without any delay.

The Budget of the State Government is a policy document, which shows the progress of the State. Therefore, assessment and the finalisation of the Budget estimates is the top management function of the Department.

Endnotes

[1] The French merchants of the middle ages carried their money in a bougette or a little bag, a word that has been derived from the Latin word 'bugla' meaning a leather bag.

[2] The phrase was first used in 1773. Gradually, the word budget came to be used for proposals themselves carried to the Parliament for approval instead of the container of the budget. The term Budget is now widely used in all modern Governments as the entire financial process involving the preparation of budget estimates of revenue and expenditure, its enactment by the legislature, its executing, accounting and audit. It is a term, which implies the plan of expenditure and revenue usually to balance that expenditure. The traditional approach in budgeting has been to match the proposed expenditure with the resources which the Government would be able to raise. The budget is now being employed to serve diverse purposes and needs and is no longer merely statement of receipts and expenditure.

[3] In 1860 for the first time a budget system was introduced in India by Sir James Wilson, the then Finance Member of the Viceroy's Executive Council. The type of budget introduced was 'line item budget'. In those days most of the Government department/agencies were involved in general administrative activities and their main interest was to ensure legality and regularity of expenditure in terms of observance of rules and regulations. It was thought that line item budget classified in terms of end items of expenditure would serve well the purpose of ensuring legality and regularity of expenditure in terms of observance of rules and regulations.

[4] World Bank (1998), Public Expenditure Management Handbook, World Bank, Washington D.C.

[5] World Bank Public Expenditure Management Handbook.