

FINANCIAL ADMINISTRATION

COURSE CODE: M23PS02SC

Skill Enhancement Compulsory Course
Post Graduate Programme in Political Science
Self Learning Material



SREENARAYANAGURU
OPEN UNIVERSITY

SREENARAYANAGURU OPEN UNIVERSITY

The State University for Education, Training and Research in Blended Format, Kerala

SREENARAYANAGURU OPEN UNIVERSITY

Vision

To increase access of potential learners of all categories to higher education, research and training, and ensure equity through delivery of high quality processes and outcomes fostering inclusive educational empowerment for social advancement.

Mission

To be benchmarked as a model for conservation and dissemination of knowledge and skill on blended and virtual mode in education, training and research for normal, continuing, and adult learners.

Pathway

Access and Quality define Equity.

Financial Administration

Course Code: M23PS02SC

Semester- IV

Skill Enhancement Compulsory Course
Postgraduate Programme
in Political Science
Self Learning Material
(with Model question paper sets)



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Financial Administration

Course Code: M23PS02SC

Semester- IV

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Postgraduate Programme

in Political Science

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MESSAGE FROM VICE CHANCELLOR

Dear learner,

I extend my heartfelt greetings and profound enthusiasm as I warmly welcome you to Sreenarayanaguru Open University. Established in September 2020 as a state-led endeavour to promote higher education through open and distance learning modes, our institution was shaped by the guiding principle that access and quality are the cornerstones of equity. We have firmly resolved to uphold the highest standards of education, setting the benchmark and charting the course.

The courses offered by the Sreenarayanaguru Open University aim to strike a quality balance, ensuring students are equipped for both personal growth and professional excellence. The University embraces the widely acclaimed “blended format,” a practical framework that harmoniously integrates Self-Learning Materials, Classroom Counseling, and Virtual modes, fostering a dynamic and enriching experience for both learners and instructors.

The University aims to offer you an engaging and thought-provoking educational journey. The MA programme in Political Science offers an advanced study of governmental structures and processes. It combines theoretical frameworks with practical applications, emphasising policy analysis and implementation. The curriculum covers organizational theory, public policy, administrative law, governance ethics, etc. Through the courses, learners gain expertise in public sector management. This programme prepares graduates for leadership roles in government agencies, non-profits, and international organizations, as well as for further academic pursuits. The Self-Learning Material has been meticulously crafted, incorporating relevant examples to facilitate better comprehension.

Rest assured, the university’s student support services will be at your disposal throughout your academic journey, readily available to address any concerns or grievances you may encounter. We encourage you to reach out to us freely regarding any matter about your academic programme. It is our sincere wish that you achieve the utmost success.



Regards,
Dr. Jagathy Raj V. P.

01-06-2026

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BLOCK 1
**Fundamentals of Financial
Administration**

UNIT 1

Introduction to Financial Administration

Learning Outcomes

Upon completion of this unit, learners will be able to:

- define financial administration and explain its scope.
- analyse the objectives and importance of financial management in governance.
- identify the principles of sound financial administration.
- evaluate the relevance of financial administration in democratic systems.

Background

Financial administration lies at the heart of effective governance and public management. Every government, regardless of its system or size, requires a well-organised mechanism to raise, allocate, and control financial resources. The efficiency of a state largely depends on how judiciously it mobilises revenue, manages expenditure, and maintains fiscal balance. From preparing annual budgets to ensuring accountability in public spending, financial administration serves as the lifeline of governmental operations. Understanding its meaning, nature, and scope helps learners grasp how financial decisions directly shape development priorities and public welfare.

In the modern era, financial management has evolved into a scientific and systematic process that blends administrative efficiency with economic rationality. Governments are no longer mere spenders of public money; they act as trustees responsible for optimising scarce financial resources to achieve national goals. Sound financial management thus involves setting objectives, formulating fiscal policies, and monitoring implementation to ensure transparency and responsibility. The growing complexity of public finance, along with challenges like fiscal deficits and public debt, makes it essential to study the objectives and importance of financial management in contemporary governance.

Moreover, financial administration carries profound significance in democratic systems where accountability and public participation are core values. Sound financial

practices, anchored in principles such as efficiency, transparency, economy, and equity, help maintain citizens' trust in governance. Through budget debates, audits, and legislative control, democracies ensure that financial authority is exercised responsibly and ethically. Hence, exploring the principles and practices of financial administration provides a foundational understanding of how democratic governments sustain economic stability, promote social justice, and uphold fiscal responsibility.

Keywords

Financial Administration, Public Expenditure, Accountability, Transparency, Principles of Economy, Fiscal Responsibility

Discussion

1.1.1 Definition, Nature, and Scope of Financial Administration

1.1.1.1 Meaning of Financial Administration

☐ Financial Administration

Financial administration refers to the processes, institutions, and mechanisms through which public funds are raised, allocated, managed, and audited to ensure both legality and efficiency in governance. Scholars throughout history have emphasised its centrality to the functioning of the state. For example, Kautilya, in Arthashastra, observed that "all state activities depend first on the treasury. Therefore, a king shall devote his best attention to it. A system with a depleted treasury eats into the very vitality of citizens and the country." This early articulation underlines the timeless importance of a sound exchequer for state stability and citizen welfare.

Centrality to the functioning of the state

☐ State Centrality

In the modern era, L.D. White defined financial management as "those operations designed to make funds available to officials and to ensure their lawful and efficient use." Similarly, Jaze Gaston described it as "that part of government organisation which deals with the collection, preservation, and distribution of public funds, with the coordination of public revenue and expenditure, with the management of credit operations on behalf of the State, and with the general control of the financial affairs of the public household."



Definitions of Financial Administration

☐ Scope Expansion

Expanding the scope, M.S. Kendrick argued that "financial administration covers all the aspects of managing the economy and balancing the payments for socio-economic development in the country, the preparation of budgets, methods of administering the various revenue resources, the custody of public funds, procedures in expending money, keeping financial records and the like." Likewise, Dimock concisely put it as a series of steps "whereby funds are made available through certain official procedures ascertaining their legal and efficient use," with budgeting, auditing, and purchase and supply as its main ingredients.

M.S. Kendrick & Dimock

☐ Holistic Discipline

From these perspectives, financial administration emerges not merely as an accounting exercise but as a holistic discipline encompassing budgeting, expenditure, debt management, taxation, financial planning, and auditing. It represents the nerve centre of governance, linking resources to public policies and development outcomes

1.1.1.2 Nature of Financial Administration

☐ Debate on whether a science or an art

The nature of financial administration has long been a subject of debate, especially regarding whether it should be viewed as a science or an art. Scholars generally agree that it falls within the domain of social science, as it deals with human behaviour, institutional dynamics, and value-based decision-making in the management of public finances. Broadly, two major perspectives have evolved to explain its nature: the Traditional View and the Modern View.

Traditional View

☐ Traditional View

The traditional approach regards financial administration as a collection of administrative activities concerned with the generation, regulation, and distribution of monetary resources necessary for the maintenance and growth of public organisations. It focuses primarily on the administrative functions involved in ensuring the systematic flow of funds and the establishment of mechanisms to ensure their proper and efficient utilisation. From a systems perspective, financial administration is seen as an integral sub-system supporting the larger administrative machinery of the government.

Focus on administrative functions

☐ Administrator Role

In this view, the financial administrator bears the responsibility of ensuring adequate financial support for the smooth functioning of public organisations. Their role involves planning, programming, organising, and directing financial operations to achieve the objectives of public policy effectively. The officials engaged in this process are considered financial managers who perform managerial functions of a financial nature.

Financial managers

☐ Pure theory of public finance

This view draws heavily from the pure theory of public finance, represented by scholars such as Seligman, who argued that public finance should be studied objectively, focusing on issues like public income, expenditure, and debt without being influenced by political or ideological considerations. Adherents to this school of thought maintain a value-neutral stance, seeing financial administration as a technical and rational process rather than a political one. As Jaze Gaston aptly observed, financial administration is that part of governmental activity concerned with the collection, preservation, and distribution of public funds.

Modern View

☐ Modern Perspective

In contrast, the modern perspective treats financial administration as an integral component of the broader management process within public organisations. It extends beyond the narrow tasks of raising and disbursing funds, recognising that almost every administrative decision in government carries financial implications. Hence, financial administration is seen as a dynamic process involving planning, policy formulation, coordination, control, and evaluation in relation to the financial aspects of governance.

Dynamic process

☐ Value Perspective

The modern view also rejects the value-neutral position of the traditional theory. Instead, as reflected in the works of economists like Adolph Wagner, F.Y. Edgeworth, and A.C. Pigou, it incorporates insights from socio-political theory, the functional theory of the Keynesian school, and the activist perspective of modern public finance theorists. According to this understanding, financial administration performs multiple



☐ Financial Roles

- ❑ Nature varies across socio-political systems

Functional Role: Recognising that the economy does not function in isolation, it uses tools such as taxation, public expenditure, and borrowing to maintain economic stability, promote growth, and ensure full employment.

Stabilising Role: Financial administration works to maintain price stability and control inflation through prudent fiscal and monetary measures.

Thus, in the modern context, financial administration provides a framework of choices concerning goals, priorities, and resources that reflect the ideological orientation and character of the state. The nature and functions of financial administration, therefore, vary across socio-political systems. In other words, what prevails in a socialist economy differs fundamentally from that in a democratic or market-based system. In essence, the nature of financial administration is shaped by the interplay of economic, political, and social forces, and it evolves continually to meet the changing needs of governance and development.

The financial administration covers all governmental activities concerned with the management and control of public finances. Broadly, it includes four key aspects: the collection, preservation, and distribution of public funds; the coordination of public revenues and expenditures; the management of credit operations on behalf of the State; and the general supervision of the government's financial affairs. In modern governments, these functions are primarily carried out by the

☐ Scope Overview

Finance Department and its subordinate agencies. However, it is important to distinguish between financial management and financial administration. While the Finance Department acts as the government's central financial agency engaged in financial management by dealing with systems, tools, and techniques that support economic decision-making, financial administration extends beyond this to include the entire framework of processes, institutions, and controls that shape the government's fiscal operations. At one level, it involves the technical dimensions of preparing, approving, and auditing government budgets. At another level, it intersects with political decision-making since resource allocation reflects policy priorities and social values. For instance, the prioritisation of social sector spending in India's budget demonstrates the political choice to strengthen welfare and equity.

1.1.1.4 Four key aspects

☐ Legislative Scope

Scholars of public administration have offered varied interpretations of the scope of financial administration. One view emphasises its association with the institutions and procedures through which the legislature exercises financial control over the executive. From this standpoint, financial administration encompasses activities such as the preparation of estimates, appropriation of funds, control of expenditure, accounting, auditing, and reporting. This legislative-centred perspective underlines executive accountability to the legislature, an essential principle in democratic governance. However, in practice, the effective participation of the legislature in determining the size, direction, and priorities of public expenditure has diminished. The growing technical complexity of financial matters and the limited financial expertise of legislators have weakened legislative control. Consequently, this view does not fully represent the comprehensive scope of financial administration.

Another perspective narrows the focus to the budgetary process, suggesting that financial administration comprises only the preparation, enactment, and execution of the budget. Though budgeting undoubtedly constitutes the core of financial administration, this view overlooks the pre-budgetary processes, such as planning and policy formulation, that influence budgetary outcomes. Therefore, a broader and integrated approach is essential—one that encompasses planning, budgeting, resource mobilisation, expenditure control, and accountability mechanisms.



Focus to the budgetary process

In contemporary understanding, the scope of financial administration can be summarised under the following interrelated components:

1. Financial Planning

Financial planning provides the foundation for effective financial administration. It involves forecasting resource needs, identifying sources of finance, and aligning financial resources with policy priorities. While budgeting may be seen as a form of short-term financial planning, broader planning takes a long-term view, linking government policies with economic goals and resource availability. The Planning–Programming–Budgeting System (PPBS) is one such attempt to integrate planning with budgeting by relating financial allocations to expected programme outcomes.

2. Budgeting

Budgeting lies at the heart of financial administration. It entails the formulation of fiscal policies, the allocation of resources among competing needs, and the design of mechanisms to ensure equity and social justice. A sound budgetary process includes the preparation, approval, and execution of the budget, as well as the review of fiscal performance. The refinement of budgetary systems and the introduction of performance-based budgeting are modern developments that enhance the effectiveness of public finance management.

3. Resource Mobilisation

The efficient mobilisation of resources is vital for meeting the ever-expanding responsibilities of the government. This involves raising revenues through taxation, fees, and other means, as well as managing public borrowing. While deficit financing may sometimes be necessary to meet developmental needs, excessive reliance on it can fuel inflation and destabilise the economy. Moreover, issues such as tax evasion and the rise of a parallel economy pose challenges to effective resource mobilisation. Financial administrators must, therefore, ensure that public debt and fiscal policies are managed prudently and transparently.

4. Investment Decisions

Sound investment decisions are essential for achieving

economic growth and social welfare. Financial administrators must evaluate the financial and socio-economic viability of capital projects through project appraisal. Given the large-scale public investments made in infrastructure and development sectors, expertise in assessing costs, benefits, and long-term impacts is critical for ensuring the optimal use of public funds.

5. Expenditure Control

Given the constraints of government revenues and the limits of taxation, expenditure control has become a central concern of financial administration. It involves ensuring that public spending is efficient, purposeful, and within the limits authorised by the legislature. Executive control focuses on the efficient use of resources, while legislative control ensures that the executive remains accountable to the public through the legislature. Both forms of control are essential for maintaining fiscal discipline and protecting the interests of taxpayers.

6. Accounting, Reporting, and Auditing

These are vital instruments for ensuring transparency and accountability in financial administration. Accounting records track how public funds are received and spent, while reporting provides information for decision-making and public scrutiny. Auditing, both internal and external, verifies the legality, accuracy, and efficiency of financial operations. In India, these functions are overseen by the Comptroller and Auditor General (C&AG), who ensures that all financial transactions conform to constitutional and statutory provisions.

7. Ease of Doing Business

In the era of globalisation and digitalisation, financial administration also plays a crucial role in promoting an enabling environment for economic growth. Governments are expected to formulate fiscal and monetary policies that facilitate business operations and enhance national competitiveness. Simplifying regulatory frameworks, improving financial transparency, and fostering e-governance are integral to this objective. By promoting the ease of doing business, financial administration contributes to sustainable development and inclusive economic progress.

In essence, financial administration encompasses a wide range of interrelated functions, from planning and budgeting to resource



☐ Scope Components

mobilisation, expenditure management, and accountability. It integrates both managerial and policy perspectives, ensuring that public financial resources are mobilised, allocated, and utilised effectively to achieve the broader goals of governance and development.

1.1.2 Objectives and Importance of Financial Management

☐ Transformation in the role of public finance

Financial management in public administration has evolved as a vital instrument of governance, reflecting the growing complexity of state functions in a modern economy. The shift from the idea of minimum government during the laissez-faire era to that of the welfare state marked a fundamental transformation in the role of public finance. As governments began to assume greater responsibility for social and economic development, financial management became central to ensuring that public funds are mobilised, allocated, and utilised effectively to achieve collective goals. In this context, financial administration is not merely about bookkeeping or expenditure control; it is a strategic mechanism to promote accountability, efficiency, and developmental progress in the public sector.

☐ "No public expenditure without legislative sanction"

1.1.2.1 Ensuring Accountability and Transparency

Accountability and transparency are the cornerstones of modern financial management. In democratic systems, the principle of "no taxation without representation" and "no public expenditure without legislative sanction" ensures that control over public finances ultimately rests with the people, through their elected representatives. This embodies the concept of parliamentary control over the public purse, which guarantees that every rupee spent by the government serves a legitimate public purpose.

☐ Strengthening of public trust

1.1.2.2 Fiscal Accountability

Transparent financial procedures and reporting systems strengthen public trust and make government operations intelligible to citizens. Through mechanisms such as budgetary control, financial audits, performance evaluation, and the publication of financial statements, financial management ensures openness in the use of public funds. These measures not only curb misuse and corruption but also enable citizens to assess whether governmental spending aligns with declared policies and priorities. Thus, financial administration functions as the bridge between fiscal accountability and democratic

governance, transforming financial decisions into instruments of popular sovereignty.

1.1.2.3 Efficient Allocation of Resources

Mobilising adequate revenue

- ❑ Maintaining a balance between revenue and expenditure

Effective financial management also involves maintaining a balance between revenue and expenditure, ensuring fiscal stability, and preventing deficits from destabilising the economy. Every decision in public administration has financial implications, whether in policy formulation, project execution, or welfare delivery, and must be assessed in terms of cost-effectiveness and long-term sustainability. By reducing wastage, managing public debt prudently, and linking expenditure to measurable outcomes, financial management becomes a vital tool for achieving maximum output from limited resources.

1.1.2.4 Developmental and Welfare Perspectives

- ❑ Developmental Role

Financial management today extends beyond fiscal prudence to embrace developmental and welfare-oriented objectives. The Great Depression of the 1930s and later Keynesian economic thought shifted the government's role from passive observer to active participant in stabilising income, employment, and growth. Financial administration now serves as an instrument for implementing fiscal policies aimed at reducing inequality, generating employment, and ensuring social justice.

1.1.2.5 Keynesian economic thought

- ❑ Welfare Focus

In a welfare state, public finance is closely linked with improving citizens' quality of life through investments in education, health, infrastructure, and social security. Planned development requires sound financial management to translate developmental objectives into actionable programmes. The allocation of public funds must therefore reflect the nation's priorities, balancing economic growth with equitable distribution. By aligning financial decisions with broader policy goals, financial administration facilitates the realisation of sustainable development and inclusive prosperity.

1.1.2.6 Role in a welfare state

- ❑ Fiscal Promotion

Moreover, through well-designed fiscal policies, governments can reduce regional disparities, attract investments, and stimulate economic activity. Thus, financial management acts as both a regulator and promoter of socio-economic development,



Summarised Overview

The nature and scope of financial administration extend beyond mere fiscal management. It involves coordination between different branches of government, legislature, executive, and audit authorities, to ensure accountability and fiscal discipline. Its scope includes formulating financial policies, preparing and executing budgets, maintaining accounts, and conducting audits to evaluate performance. This broad framework reflects how financial administration integrates both administrative efficiency and democratic control over public finances. . Thus, a clear understanding of financial administration enables policymakers and administrators to maintain a balance between developmental needs and financial prudence.

Self-Assessment Questions

1. What is meant by financial administration in public administration?
2. Explain the key objectives of financial administration in government.
3. Distinguish between financial administration and financial management.
4. What are the major components of financial administration?
5. Explain the scope of financial administration in modern governments.
6. Why is financial administration considered the backbone of public administration?
7. How does financial administration contribute to efficient use of public resources?
8. Discuss the role of financial administration in ensuring transparency and accountability.
9. What is the relationship between financial administration and public policy?
10. Why has the importance of financial administration increased in welfare states?

Assignment

1. Define Financial Administration and explain its key features in public administration.
2. Discuss the evolution of Financial Administration as a discipline and its relevance in modern governance.
3. Examine the scope of Financial Administration and explain how it differs from private financial management.
4. Analyze the importance of Financial Administration in ensuring effective governance and public accountability.
5. Explain the relationship between Financial Administration and Public Policy with suitable examples.
6. Discuss the role of Financial Administration in economic development, particularly in developing countries.

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Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

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UNIT 2

The Budget : Meaning ; Budget Cycle

Learning Outcomes

Upon completion of this unit, learners will be able to:

- explain the concept of budget
- understand the budgetary process in India.
- analyse the role of the budget as a tool of public policy.
- evaluate the challenges in budget execution and implementation.

Background

The budget is one of the most vital instruments of governance, reflecting the government's vision, priorities, and plans for national development. It is not merely a statement of income and expenditure but a comprehensive financial plan that expresses the government's policy objectives in monetary terms. Through the budget, governments mobilise resources, allocate funds to various sectors, and monitor financial performance to achieve socio-economic goals. Thus, the study of budgeting provides a foundation for understanding how public resources are managed to balance fiscal responsibility with developmental aspirations.

Over time, budgeting has evolved from a simple mechanism of expenditure control to a sophisticated tool for performance evaluation and policy formulation. Different types of budgets, such as line-item, performance, programme, and zero-based budgeting, reflect this evolution. Each type embodies a distinct approach to financial planning and control, emphasising various aspects such as accountability, efficiency, and goal orientation. Understanding these budget types helps learners appreciate how administrative and fiscal reforms are designed to improve governance outcomes and ensure the effective delivery of public services.

The process of budgeting in India involves multiple stages: formulation, approval, execution, and audit, each engaging different actors such as ministries, the legislature, and financial oversight institutions. This process ensures that public funds are spent



judiciously and in accordance with democratic principles. However, challenges such as fiscal deficits, procedural delays, and ineffective implementation often limit its efficiency. Therefore, a comprehensive understanding of the budgetary process and its underlying principles is crucial for future administrators and policymakers to design budgets that are transparent, accountable, and development-oriented.

Keywords

Budget, Line-Item Budgeting, Zero-Based Budgeting, Performance Budgeting, Budgetary Process, Fiscal Discipline

Discussion

1.2.1 The Budget

1.2.1.1 Meaning

☐ Budget Importance

A budget is one of the most important tools of public financial management. It acts as a bridge between policy formulation and policy implementation by translating the government's priorities into a detailed financial plan. In essence, a budget is a statement that presents the estimated revenues and proposed expenditures of the government for a specific financial year. It provides a financial framework through which the government mobilises resources and allocates them to meet national objectives such as economic growth, welfare, and development.

Financial framework

☐ Budget Origins

The term 'budget' originates from the old French word 'bougette', meaning a leather bag or pouch used to carry financial documents. Historically, the practice of presenting a budget in the legislature was initiated in Great Britain by Sir Robert Walpole in the 18th century. In India, although the term 'budget' is widely used, the Constitution of India refers to it as the 'Annual Financial Statement' under Article 112. The Finance Minister of India presents this document every year, usually in February, outlining the government's expected expenditure and the sources of revenue for the coming financial year.

'Annual Financial Statement'

The budget document provides comprehensive information

☐ Budget Functions

on government programmes, projects, and policies. It covers revenue and expenditure from the previous year, the revised estimates for the current year, and the proposed financial plan for the next year. It serves as a key instrument for planning, management, control, and accountability in public administration. By linking financial allocations with performance outcomes, the budget ensures that public resources are used efficiently and effectively to generate maximum public value.

1.2 1.2 Legal and Administrative Dimensions of Budget

☐ Legal Dimension

The budget has both legal and administrative dimensions that define its nature and functioning in public governance. Legally, the budget represents the formal authorisation by the legislature to the executive to raise revenues and incur expenditures. The passage of the budget by Parliament or a State Legislature signifies democratic control over public finance, thereby reinforcing the principle of accountability. No amount can be withdrawn from the Consolidated Fund of India without legislative approval. Thus, the budget is not merely a financial statement but also a legal instrument of control, ensuring that the executive acts within the financial limits sanctioned by the legislature.

Legal instrument of control

☐ Administrative Role

Administratively, the budget functions as a management tool for planning and implementing government programmes. It provides guidelines to ministries and departments for expenditure, specifies priorities, and allocates resources based on policy goals. Through the budgeting process, the government maintains discipline in financial operations, monitors performance, and ensures that funds are used for their intended purposes. The preparation, execution, and evaluation of the budget involve multiple administrative stages, including the preparation of estimates by departments, scrutiny by the Ministry of Finance, legislative approval, and subsequent implementation by administrative agencies. Hence, budgeting is both a technical and institutional process combining legal authorisation and administrative coordination.

1.2.2 Budgetary Process: Formulation and Execution

Stages: Preparation and Approval

The budgetary process in India is an elaborate exercise



❑ Budget Division's role

involving a series of systematic stages, beginning with preparation and ending with execution and audit. It represents the financial policy of the government for a particular year and reflects the priorities of governance. The financial year in India begins on April 1 and ends on March 31 of the following year. Usually, the Union Budget is presented to Parliament on the last working day of February, allowing sufficient time for legislative approval before the new fiscal year commences. The process of budget preparation and approval at the Union level is largely mirrored in the State governments as well.

Broadly, the budgetary process in India consists of three stages:

1. Budget Preparation
2. Budget Approval (Enactment)
3. Budget Execution

1.2.2.1. Budget Preparation

Budget preparation is the foundation of the government's financial planning process. It involves estimating expected receipts and expenditures for the forthcoming financial year. The Budget Division of the Ministry of Finance plays a central role in this process, coordinating with various ministries, departments, and agencies to formulate a consolidated financial statement. The preparation stage generally begins around September or October, nearly six months before the commencement of the financial year.

- ## 1. Initiation through Budget Circulars

The process formally begins when the Ministry of Finance issues a budget circular to all ministries, departments, and administrative offices. This circular provides detailed instructions and standard forms to be filled in by the Drawing and Disbursing Officers (DDOs), enabling them to project their expenditure requirements for the ensuing year.

These forms typically include:

Actual expenditure of the previous year;

Sanctioned estimates for the current year:

Revised estimates for the ongoing year;

Proposed estimates for the upcoming year, with explanatory notes for any variation;

Actuals for the corresponding period of the previous year.

This system ensures uniformity and transparency in the preparation of estimates across departments.

2. Scrutiny and Consolidation by Departments

□ Estimate Review

Once the estimates are prepared, they are examined and consolidated by the Heads of Departments and Controlling Officers within each ministry. The Administrative Ministries review the proposals to ensure that they align with the government's policy priorities and programme objectives. Schemes that have become redundant or ineffective may be discontinued, and funds are redirected to more productive programmes.

During this scrutiny, the following aspects are particularly considered:

- Continuation or completion of existing schemes;
- Need and feasibility of new schemes;
- Avoidance of lump-sum allocations without clear justifications;
- Restriction of financial provisions to the relevant fiscal year.

3. Verification by the Comptroller and Auditor General (CAG)

□ Factual verification by CAG

The consolidated estimates prepared by ministries are submitted to the Comptroller and Auditor General (CAG) for factual verification. The CAG, being the guardian of public accounts, examines the data for accuracy and comments on discrepancies, thereby ensuring financial accountability at the preliminary stage itself.

4. Review by the Ministry of Finance

□ NITI Aayog's role

After departmental scrutiny and audit verification, the Budget Division of the Ministry of Finance undertakes a detailed financial review. The estimates are checked to avoid duplication and to ensure that they adhere to principles of economy and efficiency. Proposals for new expenditure are rigorously evaluated in consultation with the NITI Aayog, which assesses their alignment with national development plans. Disagreements between ministries and the Finance Ministry, if any, are referred to the Union Cabinet, whose decision is final.

5. Cabinet Approval

The final stage of budget formulation is Cabinet approval.



☐ Revenue Estimates

The consolidated budget is presented to the Union Cabinet by the Finance Minister for consideration before being placed before Parliament. The budget is examined under three categories:

Standing Charges: covering pay, allowances, and establishment costs;

Ongoing Schemes: reviewed based on progress achieved and expected outcomes;

New Schemes: evaluated for necessity, feasibility, and fiscal sustainability.

At this stage, the Finance Ministry also prepares estimates of expected revenue in consultation with the Central Board of Direct Taxes (CBDT) and the Central Board of Indirect Taxes and Customs (CBIC). Based on these inputs, the Finance Bill is drafted, containing tax proposals and revenue measures. The entire process is conducted confidentially until the budget is formally presented to Parliament.

1.2.2.2 Budget Approval (Enactment)

Once the Cabinet approves the budget, it enters the legislative stage. This is a crucial phase where Parliament examines, debates, and authorises government expenditure. The budget thus transforms from an executive proposal into a legally sanctioned financial plan.

1. Presentation of the Budget

The Finance Minister presents the budget in the Lok Sabha, the House of the People, usually on the last working day of February. The Budget Speech comprises two parts:

Part A: A review of the previous year's financial performance and the proposed estimates for the upcoming year.

Part B: Details of tax proposals and measures for raising revenue.

☐ Legislative Stage

Since 2017, the Railway Budget has been merged with the General Budget, and a single, unified budget is presented. Along with the speech, supporting documents such as the Finance Bill, Appropriation Bill, Explanatory Memorandum, and Annual Reports of Ministries are laid before Parliament.

2. General Discussion

Following the presentation, the budget is subject to a general discussion in both Houses. During this stage, members discuss

☐ General Discussion

the overall policy framework, financial priorities, and allocation of resources. However, no amendments or voting take place at this stage. The Finance Minister responds to the discussion and clarifies doubts raised by members.

☐ Committee Scrutiny

3. Departmental Scrutiny and Demands for Grants

After the general discussion, the House is adjourned for a short period to allow Departmentally Related Standing Committees (DRSCs) to examine the Demands for Grants for each ministry. These committees submit detailed reports to Parliament, suggesting improvements or economies in expenditure. Upon resumption, the Lok Sabha discusses and votes on these demands, ministry-wise.

☐ Cut Motions

4. Voting and Cut Motions

Members of Parliament can move cut motions to express disapproval or suggest reductions in proposed allocations:

Policy Cut: to oppose a particular policy (reduction to ₹1).

Economy Cut: to reduce a specific amount or eliminate an item.

Token Cut: to highlight dissatisfaction on a specific issue (reduction by ₹100).

Although rarely passed due to the majority held by the ruling party, these motions enhance transparency and legislative oversight. Once the time allotted for voting expires, all remaining demands are automatically passed through a procedure known as guillotine.

☐ Budget Bills

5. Passing of the Appropriation and Finance Bills

After the demands for grants are voted on, the Appropriation Bill is introduced to authorise the withdrawal of funds from the Consolidated Fund of India. Similarly, the Finance Bill, containing taxation proposals, is passed to give legal effect to the government's revenue measures. Both bills require the President's assent to become Acts.

Vote on Account

There are situations, especially in an election year or when the budget requires more time for legislative scrutiny, where it is not feasible for the government to complete the



☐ Vote Account

full budget approval process before the beginning of the new financial year on 1st April. To avoid a financial vacuum, the Constitution permits the Lok Sabha to pass a Vote on Account, which authorises the government to withdraw funds from the Consolidated Fund of India for a limited period, typically two months. Unlike the full budget, a Vote on Account does not alter tax proposals or introduce new expenditure programmes; it merely allows the government to continue essential services and meet routine administrative expenditure. This ensures continuity of governance while respecting the legislative prerogative of the newly elected or reconstituted Parliament. A Vote on Account is thus a limited, stop-gap financial measure, not a substitute for the regular budget.

Sunset Legislation: Time-Bound Fiscal and Policy Provisions

In addition to temporary financing mechanisms, the contemporary budgetary process has increasingly adopted the concept of Sunset Legislation, wherein certain laws, schemes, or fiscal provisions are given a predefined validity period. At the end of this period, the law or scheme automatically expires unless explicitly renewed by Parliament. This mechanism prevents outdated, inefficient, or redundant programmes from continuing indefinitely without evaluation. Sunset clauses are particularly useful in taxation, subsidies, regulatory frameworks, and pilot initiatives, as they impose a disciplined review cycle on public expenditure and policy outcomes. For example, tax incentives in specific sectors may be granted only for a fixed term, after which their economic impact must be assessed before renewal. By integrating sunset clauses, the budgetary process becomes more accountable, evidence-based, and aligned with principles of fiscal prudence.

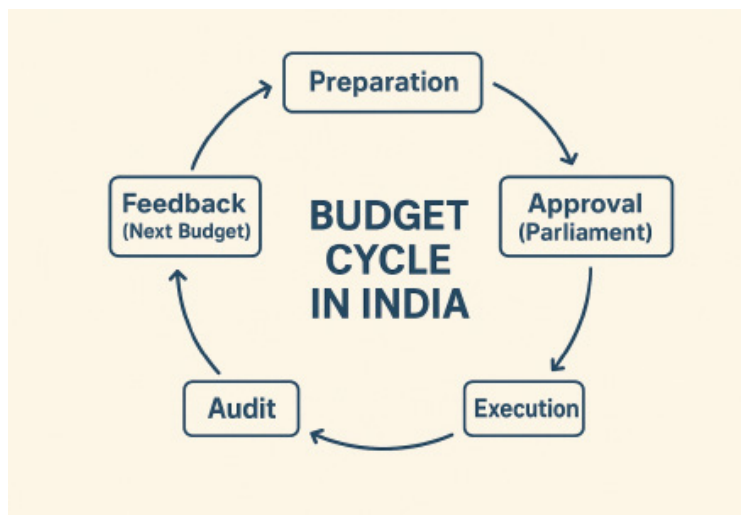


Figure 1.2.2: Budget Cycle in India

1.2.2.3 Budget Execution

The execution of the budget represents the final and most dynamic stage of the budgetary process in India. It involves the implementation of financial plans through the judicious use of funds that have been authorised by the legislature. In essence, this phase converts financial allocations into concrete administrative actions and public services, thereby translating government policies into outcomes that directly affect citizens.

Final and most dynamic stage

Although the approval of the budget provides the necessary legal authority for expenditure, effective execution requires administrative capacity, financial discipline, and continuous monitoring. A well-formulated budget may fail in its purpose if its implementation lacks coherence with the original policy objectives. Hence, any modifications made during the financial year must remain consistent with the approved fiscal plan to prevent inefficiencies, duplication, or delays in project performance. The success of budget execution depends largely on institutional capacity, coordination among agencies, and adherence to financial regulations such as the General Financial Rules (GFR) 2005.

☐ Budget Execution

1. Commencement of Budget Execution

Budget execution begins immediately after the Finance Bill and the Appropriation Bill are passed by Parliament and receive the President's assent. Once these bills become Acts, the concerned ministries and departments are legally empowered to incur expenditure as per the approved allocations. As we mentioned before, until the final enactment of these laws, expenditure can only be incurred under the provisions of a Vote-on-Account.

❑ Execution Start

The execution process covers both the expenditure and revenue sides of the budget. On the expenditure side, the focus is on ensuring that funds are utilised efficiently for approved purposes, while on the revenue side, emphasis lies on the systematic collection and management of government receipts, including taxes and non-tax revenues.

2. Machinery for Budget Execution

The implementation of the budget involves several administrative and financial authorities responsible for expenditure control and fund management. The key components of this machinery are:

Controlling Officers: These officers are responsible for monitoring and regulating expenditure within their departments, ensuring that spending remains within sanctioned limits and conforms to policy guidelines.

Competent Authorities: They issue financial sanctions for specific items of expenditure and authorise payments.

❑ Execution Machinery

Drawing and Disbursing Officers (DDOs): They prepare bills for expenditure and ensure timely disbursement of funds to various schemes and activities.

Payments and Accounts Offices: These offices maintain detailed financial records and are responsible for making payments according to the government's accounting procedures.

All these functionaries must observe high standards of financial propriety as laid down in the GFR 2005, which prescribes principles of economy, transparency, and accountability in public spending.

3. Execution on the Revenue Side

The revenue side of the budget pertains to the collection and management of government income from various sources such as taxes, duties, and non-tax receipts. The process involves:

Collection of Revenues: Ensuring that taxes, fees, and duties are collected efficiently and in accordance with the law;

Custody of Collected Funds: Depositing all revenues in the Consolidated Fund of India or other designated public accounts;

☐ Revenue Management

Distribution of Funds: Allocating the collected revenues to the respective ministries and agencies for utilisation.

The Department of Revenue under the Ministry of Finance oversees the machinery responsible for tax collection. It exercises control through two statutory bodies:

The Central Board of Direct Taxes (CBDT), which manages income tax and corporate tax administration; and

The Central Board of Indirect Taxes and Customs (CBIC), which oversees customs, goods and services tax (GST), and excise operations.

4. Role of Financial Advisers

Financial control and advisory mechanisms form a vital part of budget execution. There are two categories of Financial Advisers (FAs): External and Internal.

The External Financial Adviser, functioning on behalf of the Ministry of Finance, offers guidance to ensure compliance with the government's overall fiscal policy.

☐ Integrated Financial Advisers

The Internal Financial Adviser (IFA) works within each ministry or department, assisting in budget formulation, fund management, expenditure control, and evaluation of new financial proposals.

The system of Integrated Financial Advisers (IFA) was introduced in 1975 to strengthen internal financial management within ministries. Over time, the IFA's responsibilities have expanded to include comprehensive functions such as performance budgeting, expenditure monitoring, procurement oversight, and ensuring fiscal discipline across departmental operations.

5. Accounting and Audit

Once the budget is executed, all financial transactions are recorded according to prescribed accounting procedures. Each ministry maintains detailed accounts of receipts and expenditure through its Pay and Accounts Offices (PAOs). These accounts are later audited by the Comptroller and Auditor General of India (CAG), who ensures that public funds are spent in conformity with the approved budget and established rules. The



auditing process not only detects irregularities but also promotes accountability and transparency in financial administration.

Summarised Overview

Budgeting is a vital instrument of governance that connects policy, planning, and financial management. It serves as both a legal and administrative tool for translating governmental priorities into financial terms and actionable plans. By laying down expenditure and revenue frameworks, the budget ensures fiscal discipline, efficient resource utilisation, and accountability. Guided by principles such as comprehensiveness, accuracy, and periodicity, budgeting promotes transparency and democratic control over public finance. Thus, it reflects not only the financial health of the state but also its policy direction and commitment to public welfare.

The budgetary process in India, encompassing formulation, legislative approval, and execution, exemplifies democratic governance and financial accountability. The formulation stage aligns policy goals with fiscal realities, while parliamentary scrutiny ensures transparency and public oversight. Budget execution, transforming allocations into actions, relies on effective administrative mechanisms, fiscal propriety, and institutional checks through bodies like the Comptroller and Auditor General. Despite challenges such as fiscal deficits and implementation gaps, the Indian budget remains a powerful instrument for policy realisation and public welfare. Strengthening transparency, institutional capacity, and fiscal prudence is essential to enhance its effectiveness and sustain public trust in governance.

Self-Assessment Questions

1. What is meant by the budget cycle in financial administration?
2. What are the main stages involved in the budget cycle?
3. What is the importance of budget formulation?
4. How does budget presentation differ from budget formulation?
5. What happens during the budget approval stage?
6. Why is budget execution considered a crucial phase?
7. What is the role of accounting in the budget cycle?

8. How does financial reporting ensure transparency in governance?
9. What is the significance of audit in public financial administration?
10. How does evaluation help in improving future budgets?

Assignment

1. Explain the concept of the budget cycle and discuss its major stages in detail.
2. Critically examine the process of budget formulation and its significance in financial administration.
3. Describe the role of the legislature in budget presentation and approval. How does it ensure financial accountability?
4. Analyze the importance of budget execution and the challenges faced during implementation.
5. Discuss the roles of accounting and reporting in maintaining transparency and efficiency in public finance.
6. Evaluate the significance of audit and evaluation in the budget cycle. How do they contribute to good governance?

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Suggested Reading

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Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

SGOU

UNIT

3

Role of the Legislature and Execution in budgeting

Learning Outcomes

After completing this unit, learners will be able to:

- explain the respective roles of the executive and legislature in the budgeting process.
- describe the executive's responsibilities in budget formulation and execution.
- analyse the legislature's role in budget approval and financial control.
- evaluate the importance of legislative committees in ensuring financial accountability.
- examine the relationship and checks and balances between the executive and legislature in budgeting.

Background

Budgeting in democratic governance is a collaborative and interdependent process involving both the executive and the legislature. The executive branch acts as the primary architect of the budget, responsible for preparing, presenting, and implementing financial plans in accordance with national priorities and policy goals. Through ministries and departments, the executive estimates revenues, determines expenditure priorities, and allocates resources to sectors such as education, healthcare, infrastructure, and defence. Once the budget is formulated, it is presented to the legislature, which represents the will of the people and exercises the constitutional authority to examine, debate, modify, and approve financial proposals. The legislature ensures that public money is raised and spent only with its consent, thereby upholding the democratic principle of “no taxation without representation.” Through debates, voting on demands for grants, and the passage of the Appropriation and Finance Bills, the legislature grants legal authority for government spending and taxation. Beyond approval, legislative oversight continues through committees such as the Public Accounts Committee and the Estimates Committee, which scrutinise government expenditure and audit reports. The executive then assumes responsibility for budget execution by allocating funds, monitoring spending, maintaining accounts, and ensuring compliance with financial regulations. This dynamic relationship between the executive and the legislature establishes a system



of checks and balances that promotes transparency, accountability, fiscal discipline, and efficient use of public resources. In modern governance, the success of public financial management depends largely on the effective coordination and cooperation between these two branches of government.

Keywords

Budget Formulation, Budget Execution, Legislative Approval, Financial Control, Demands for Grants, Appropriation Bill, Finance Bill, Legislative Committees, Fiscal Discipline, Checks and Balances

Discussion

☐ Budget Significance

1.3.1 Introduction

Budgeting serves as a fundamental aspect of financial planning, enabling individuals, organizations, and governments to allocate resources effectively. By systematically outlining income and expenses, budgeting provides a framework for achieving financial stability and meeting both short-term and long-term goals. This process not only facilitates informed decision-making but also enhances accountability and resource management. Whether applied to personal finances or institutional operations, budgeting is a critical tool for ensuring fiscal discipline and promoting sustainable growth.

☐ Executive Role

1.3.1.2 Role of Executive in Budget Formulation

The executive holds a pivotal role in shaping the budget formulation process within financial administration. The responsibility of preparing the annual budget primarily lies with the executive branch, often spearheaded by the finance ministry or department. This budget serves as a reflection of the government's policies, priorities, and developmental objectives. The process commences with the finance ministry issuing directives to various administrative departments, instructing them to submit estimates of anticipated expenditures and revenues for the forthcoming fiscal year.

Departments develop their estimates based on existing programs, proposed initiatives, and policy commitments. These submissions are meticulously reviewed by the finance ministry to maintain financial discipline, optimize resource utilization, and align spending with the government's overarching priorities.

☐ Estimate Preparation

In this phase, the executive assesses competing demands for resources and makes vital allocation decisions. This includes prioritizing sectors such as education, healthcare, infrastructure, and defense, guided by strategic policy goals and available fiscal resources. Revenue forecasting forms another critical aspect of the executive's role, wherein projections for income from taxes, duties, and other non-tax revenues are made. Expenditure proposals are then balanced against anticipated revenues, often necessitating adjustments to ensure fiscal stability. At times, the executive may introduce new taxation policies or modify existing frameworks to address budgetary requirements.

☐ Executive Coordination

Coordination is a key facet of the executive's involvement in budget formulation. The finance ministry works closely with all departments to refine the budget proposals, resolve potential conflicts, and ensure coherence across the submissions. Once reviewed and amended, these departmental estimates are consolidated into a unified budget document. The final step involves cabinet approval, signifying the executive's highest decision-making authority. Upon securing cabinet endorsement, the budget is presented to the legislature for deliberation and ratification. By preparing and shaping the budget in alignment with governmental policies and prevailing economic realities, the executive emerges as the central architect in this critical process.

1.3.1.3 The Role of the Executive in Budget Execution

☐ Execution Responsibility

Budget execution involves implementing the budget after it has been formally approved by the legislature. At this stage, the responsibility shifts to the executive, which is tasked with actualizing financial plans and ensuring public funds are used in alignment with approved policies and legal standards. Proper execution is vital, as even a well-crafted budget loses its impact if not implemented effectively. One of the executive's primary responsibilities in budget execution is the allocation of funds to various ministries, departments, and agencies. Following the legislature's passage of the Appropriation Act, the finance ministry facilitates the authorization and phased release of funds, typically on a quarterly or monthly basis. This controlled disbursement approach promotes financial discipline and reduces the risk of overspending.

The executive also establishes procedures and guidelines for expenditure. By issuing financial regulations, treasury policies, and accounting frameworks, it ensures that every department

Executive Oversight

utilizes funds strictly for their designated purposes as outlined in the budget. Departments are required to adhere to formal processes such as obtaining approvals, adhering to tender procedures, and securing necessary sanctions before incurring expenses. These measures are critical for safeguarding public funds and enhancing transparency. Supervision and monitoring form another essential component of the executive's role. Ministries and departments consistently track their expenditures to remain within budgetary limits. Concurrently, the finance ministry monitors revenue collection and spending trends to identify and address potential issues like overspending or revenue shortfalls. When required, it may authorize the reallocation of funds between budget categories under specified rules.

□ Expenditure Control

The executive also establishes procedures and guidelines for expenditure. By issuing financial regulations, treasury policies, and accounting frameworks, it ensures that every department utilizes funds strictly for their designated purposes as outlined in the budget. Departments are required to adhere to formal processes such as obtaining approvals, adhering to tender procedures, and securing necessary sanctions before incurring expenses. These measures are critical for safeguarding public funds and enhancing transparency. Supervision and monitoring form another essential component of the executive's role. Ministries and departments consistently track their expenditures to remain within budgetary limits. Concurrently, the finance ministry monitors revenue collection and spending trends to identify and address potential issues like overspending or revenue shortfalls. When required, it may authorize the reallocation of funds between budget categories under specified rules.

Financial Accountability

Additionally, the executive ensures proper accounting and financial record-keeping during budget execution. Government accounting systems capture all revenues and expenditures to provide an accurate overview of public finances. These records serve as a foundation for audits and legislative scrutiny at a later stage. The executive holds a pivotal role in budget execution through fund allocation, strict regulation of spending, ongoing performance monitoring, accurate accounting, and enforcement of financial discipline. Effective execution translates government policies into tangible programs and services that directly benefit the public.

1.3.1.4. The Role of the Legislature in Budget Approval

The legislature holds a critical constitutional responsibility

☐ Budget Approval

in the approval of the budget. In democratic systems, authority over public finances lies with representatives of the people. This principle ensures that no tax is levied, and no public funds are spent without legislative consent, embodying the concept of government accountability to its citizens. As guardians of public resources, legislatures ensure that government expenditures uphold principles of transparency, accountability, and legality.

☐ Budget Presentation

Presentation and Initial Stages

The budget approval process begins when the executive submits the annual budget to the legislature. This document outlines projected revenues, expenditures, taxation plans, and policy priorities for the upcoming financial year. After presentation, the legislature undertakes a multi-phase process involving discussions, scrutiny, and eventual approval.

☐ General Discussion

1.3.2 General Discussion

The initial stage involves a broad discussion where legislators deliberate on the budget's overall framework, such as government fiscal policies, economic agendas, development priorities, tax proposals, and projected deficits. This phase examines the budget's alignment with national interests and provides members an opportunity to reflect public sentiment and raise pertinent concerns.

Although this stage does not involve voting, it is pivotal in shaping the direction of detailed scrutiny that follows by assessing the government's financial strategy and policy objectives.

☐ Grant Scrutiny

1.3.2.1 Examination of Demands for Grants

Following the general debate, the legislature scrutinizes specific departmental or ministry expenditure requests, referred to as "Demands for Grants." Each demand undergoes detailed evaluation, during which legislators question its necessity and assess whether resources are being utilized effectively.

This phase is crucial for ensuring fiscal prudence, as members can address issues like inefficiencies or unwarranted spending. It reinforces accountability by compelling government departments to justify their financial needs transparently.

1.3.2.2. Cut Motions: A Tool for Financial Oversight

Cut motions empower the legislature to propose reductions



❑ Cut Motions

in government expenditure requests and serve as instruments of fiscal control and accountability.

Policy Cut Motion: Advocates reducing an expenditure item to a nominal amount as a sign of disapproval of underlying policies.

Economy Cut Motion: Suggests a specific decrease in spending, emphasizing cost-effectiveness and discouraging inefficiencies.

Token Cut Motion: Proposes a minor reduction to spotlight a particular grievance or issue within administration.

While most cut motions are not adopted, they are vital for fostering debate and holding the executive accountable for its financial decisions.

1.3.2.3. Voting on Demands

The next step involves legislative voting on each demand for grants. Successful voting grants formal approval for allocating funds to specific expenditures. Conversely, rejection of a demand signals dissatisfaction with governmental policies and may even have broader political repercussions.

This stage solidifies financial oversight as no government spending can occur without explicit approval from the legislature.

1.3.2.4 Legislative Authorization through Bills

Upon approving the demands for grants, two significant bills—the Appropriation Bill and Finance Bill—require legislative attention to provide legal authorization for expenditure and taxation:

❑ Legislative Authorization

Appropriation Bill Grants the executive permission to withdraw funds from the Consolidated Fund to cover approved expenditures. Until passed, the government cannot access these funds legally

Finance Bill Outlines taxation measures, including any changes to tax rates or new revenue-generating initiatives. Its passage ensures that taxation remains under legislative purview, adhering to principles of democratic representation.

Post-Budget Approval Monitoring The legislature's engagement extends beyond budget approval. It maintains

☐ Post-Budget Oversight

oversight on how the executive implements approved financial measures. Through legislative committees and reports such as audit findings from agencies like the Comptroller and Auditor General (CAG), accountability is continuously monitored to ensure adherence to approved policies and efficient execution. The legislature's role in budget approval acts as a cornerstone of democratic governance. By scrutinizing policies, ensuring financial responsibility, authorizing expenditures, and monitoring implementation, it safeguards public interest and sustains government accountability at every step of the budgeting process.

1.3.2.5 Legislative Oversight of Public Finance

☐ Financial Oversight

The oversight of public finance by the legislature is a cornerstone of democratic governance. This process is rooted in the principle that public funds belong to the people and can only be raised and allocated with the consent of their elected representatives. Such oversight ensures accountability, transparency, and prudent management of financial resources by the executive branch. Acting as the custodian of public finances, the legislature plays a vital role in safeguarding against misuse, inefficiency, and corruption.

☐ Taxation Control

A key element of this control is the power of taxation. The executive branch cannot impose taxes without legislative approval. Any proposal involving new taxes, changes to tax rates, or repeal of existing taxes must be presented to and sanctioned by the legislature. This embodies the democratic ideal of "no taxation without representation," ensuring that citizens have a voice in fiscal decisions that impact them directly. Equally important is the legislature's role in sanctioning government expenditure. While the executive drafts the budget, it cannot disburse public funds without legislative consent. Legislators assess and debate funding requests from various ministries and departments to determine if proposed expenditures are necessary, justified, and consistent with national priorities.

☐ Appropriation Authority

The passage of the Appropriation Bill is another vital instrument of financial oversight. This bill grants legal authority for the government to withdraw money from the public treasury. Without such authorization, the executive cannot legally allocate funds. This mechanism ensures that government spending remains within boundaries set by elected representatives. Beyond budget approval, financial scrutiny and debate are fundamental components of legislative oversight. During budget sessions,



lawmakers critically examine policies, question government officials, and draw attention to inefficiencies or wasteful expenditures. This provides both opposition and ruling party members an opportunity to assess government performance and recommend improvements.

☐ Committee Oversight

A particularly effective mechanism for financial oversight is the committee system. Specialized committees such as the Public Accounts Committee, Estimates Committee, and Committee on Public Undertakings conduct detailed examinations of government finances, audit reports, and expenditure patterns. Functioning year-round, these bodies provide impartial evaluations and hold the executive accountable for its financial management through exhaustive reports and recommendations. Post-budget audits represent another layer of control. Once funds have been disbursed, the legislature assesses how effectively they were utilized by examining audit findings that flag issues like irregularities, misjudgments, or corruption. This process ensures adherence to the approved budget and reinforces fiscal discipline within the executive branch.

☐ Oversight Challenges

The significance of legislative control over public finance lies in its ability to promote responsible fiscal management, deter the misuse of public resources, and bolster democratic accountability. It fosters transparency in governance and enhances public trust in the administration's stewardship of national resources. However, certain challenges persist. Legislatures often face constraints such as insufficient time for thorough scrutiny of financial matters, the technical complexity of budget documents, and strict party loyalties that may hinder independent assessments. Despite these hurdles, legislative oversight remains a critical mechanism for ensuring that public funds are managed efficiently and directed toward societal welfare.

☐ Budget Procedures

1.3.3. Budgetary Procedures (Demands, Grants, Bills)

Budgetary procedures refer to the formal steps through which government expenditure and revenue proposals are examined, approved, and authorized by the legislature. These procedures ensure that public funds are spent legally, responsibly, and in accordance with democratic principles. The major components of these procedures include Demands for Grants, Voting on Grants, the Appropriation Bill, and the Finance Bill. The first step in the budgetary procedure after general discussion is the presentation of Demands for Grants. Each ministry or

❑ Demand Discussion

department submits a demand for the funds required to carry out its functions during the financial year. These demands include estimates of expenditure for various schemes, salaries, infrastructure projects, and administrative activities. The demands are presented separately for each ministry, allowing detailed examination by the legislature.

The legislature then discusses these demands. Members of the legislature examine the necessity, efficiency, and justification of proposed expenditures. They question ministers, seek clarifications, and highlight areas where funds may be excessive or insufficient. This stage provides an opportunity for democratic scrutiny of government spending and ensures accountability. During the discussion of demands for grants, members can introduce Cut Motions, which are proposals to reduce the amount requested by the government. Cut motions serve as important tools of financial control and political accountability.

There are three main types of cut motions:

❑ Types of Cuts

Policy Cut Motion – This motion proposes that the amount of the demand be reduced to a nominal sum. It represents disapproval of the policy underlying the demand and allows the legislature to criticize government policies.

Economy Cut Motion – This motion suggests a specific reduction in the demand. Its aim is to promote economy and efficiency by reducing wasteful or unnecessary expenditure.

Token Cut Motion – This motion proposes a small reduction to highlight a specific grievance or issue within the administration.

Although cut motions are rarely passed, they are important because they enable discussion, criticism, and public accountability.

❑ Voting & Appropriation

After the discussion and voting on individual demands, the next step is the Voting on Demands for Grants. Through voting, the legislature formally approves government expenditure. This approval signifies the consent of the people's representatives and reinforces the democratic principle that public money cannot be spent without legislative authorization. Once the demands for grants are approved, the government introduces the Appropriation Bill. This bill authorizes the executive to withdraw money from the Consolidated Fund to meet the

approved expenditures. Even after the legislature has voted on demands, the government cannot legally spend money without the passage of the Appropriation Bill. Therefore, it provides the legal basis for government expenditure.

❑ Finance Bill

Another key component is the Finance Bill, which deals with the government's taxation proposals. It includes provisions related to new taxes, changes in existing tax rates, and other financial measures aimed at raising revenue. The legislature debates and approves the Finance Bill to ensure that taxation remains under democratic control. These procedures collectively ensure that government spending and taxation are subject to legislative scrutiny and approval. They maintain financial discipline, transparency, and accountability in public finance. Through demands, grants, and bills, the legislature exercises its constitutional authority over the public treasury and safeguards the interests of citizens.

1.3.4 The Role of Legislative Committees: Public Accounts Committee and Estimates Committee

❑ Committee Role

Legislative committees serve an indispensable function in bolstering financial accountability and ensuring the efficient management of public expenditure. Given the legislature's practical limitations in scrutinizing the intricate and technical dimensions of public finance on a year-round basis, much of this evaluative work is delegated to specialized committees. Foremost among these are the Public Accounts Committee (PAC) and the Estimates Committee, which operate as key mechanisms of parliamentary oversight. These bodies play a pivotal role in ensuring that public resources are allocated and utilized effectively and in accordance with legislative intent.

1.3.4.1 Public Accounts Committee (PAC)

❑ Public Accounts

The Public Accounts Committee is one of the most prominent instruments for financial oversight within legislative frameworks. Its principal mandate is to examine government accounts and determine whether public funds have been expended in alignment with the authorization provided by the legislature. The PAC primarily derives its inputs from audit reports prepared by the Comptroller and Auditor General (CAG)

The committee's evaluative responsibilities comprise: - Assessing whether funds allocated by the legislature were utilized for their designated purposes. - Verifying whether

❑ PAC Functions

expenditures were conducted in compliance with established rules and regulations. - Investigating instances of waste, fraud, corruption, or other irregularities in financial administration. It is important to note that the PAC does not critique government policies but instead concentrates on the manner and efficiency of policy implementation and financial expenditure. Through detailed review of audit findings and questioning of officials, the PAC fosters executive accountability. Its reports commonly illuminate instances of financial mismanagement and proffer recommendations for corrective action, thereby enhancing fiscal discipline within public administration.

1.3.4.2 Estimates Committee

❑ Estimates Committee

In contrast to the PAC's retrospective focus, the Estimates Committee is concerned with prospective fiscal planning and expenditure patterns. Its overarching objective is to ensure that government operations are conducted with economy, efficiency, and effectiveness. This committee scrutinizes budget proposals with a view to identifying opportunities for cost reduction while also recommending measures to improve administrative practices. Key functions of the Estimates Committee include: - Analyzing budgetary allocations across various governmental departments. - Proposing alternative courses of action aimed at optimizing resource utilization and achieving economic efficiency. - Advocating for enhancements in organizational structures and administrative mechanisms. - Highlighting areas where government spending can be curtailed to avoid wastefulness .

❑ Committee Significance

Unlike the PAC, which focuses on examining past expenditures, the Estimates Committee operates with a forward-looking perspective aimed at refining processes for future financial governance. Significance of Legislative Committees The contributions of legislative financial committees are manifold and central to sound governance. First, they facilitate comprehensive and ongoing scrutiny of public expenditure—a task that cannot be fully addressed during routine legislative sessions. Second, they function with a relatively apolitical orientation, concentrating on administrative and technical evaluations rather than engaging in partisan discourse. Third, their processes promote transparency by compelling government agencies to justify their fiscal decisions.

These committees also reinforce the synergy between legislative and executive branches, thereby fostering institutional



☐ Fiscal Accountability

accountability on a continual basis. The recommendations they deliver not only help preclude misuse of public funds but also offer pathways for improved operational efficiency and effective governance practices. The Public Accounts Committee and the Estimates Committee stand as indispensable pillars of legislative fiscal oversight, addressing both retrospective assessments of past expenditures and proactive improvements to future financial planning. By enhancing transparency, ensuring accountability, and advocating for efficient resource allocation, these committees contribute substantively to responsible public finance management and the broader goal of sustaining democratic integrity within governance structures.

☐ Executive–Legislature

1.3.5 Executive–Legislature Relationship in Budgeting

The relationship between the executive and legislature in the budgeting process is a fundamental component of democratic financial management. Rather than being the sole responsibility of one entity, budgeting is a collaborative, interdependent process involving these two branches of government. The executive is tasked with preparing and implementing the budget, while the legislature examines, approves, and ensures accountability. This interaction fosters a system of checks and balances, which is crucial for sound financial governance.

☐ Budget Collaboration

The executive assumes a leading role in preparing the budget. Individual ministries and departments draft estimates, which are then consolidated into a national budget by the finance ministry. With its access to administrative resources, technical expertise, and comprehensive financial data, the executive is well-positioned to formulate a detailed budget. However, it lacks unilateral authority to impose taxes or allocate public funds without approval from the legislature. This requirement signifies the legislature's crucial role in the budgeting process. When the executive presents the proposed budget, the legislature's responsibilities—scrutiny and approval—come into play. Legislators engage in debates, evaluate funding requests, assess taxation proposals, and challenge ministers on specific policies. Through these activities, they ensure that government actions align with societal priorities and public expectations. This stage highlights the legislature's role as the representative voice of the people in directing financial decisions.

The dynamic between these two branches is anchored in the principle of checks and balances. While the executive drafts and proposes the budget, the legislature holds the authority to

☐ Checks & Balance

approve, amend, or reject these proposals. Mechanisms such as debates, cut motions, grant votes, and legislative control over Appropriation and Finance Bills allow for adequate oversight. This framework prevents excessive centralization of financial authority within the executive branch. At the same time, effective budgeting demands mutual cooperation and coordination. The executive requires legislative approval to act upon its proposals, while lawmakers depend on accurate information and updates from the executive for informed oversight. This interconnectedness fosters shared accountability and underscores the commitment to responsible governance.

☐ Committee Cooperation

The committee system enhances this relationship significantly. Legislative committees thoroughly analyze government accounts and budgetary proposals throughout the year. By closely engaging with executive departments, seeking clarifications, and recommending adjustments, these committees ensure ongoing accountability long after the budget is enacted. Nonetheless, this cooperative structure faces challenges. In many countries, the executive often dominates the budgeting process due to its technical expertise and control over critical information. Factors such as limited time for legislative debate, party loyalty, and political pressures can undermine effective scrutiny by lawmakers. However, robust committee systems and greater transparency can mitigate these issues and restore equilibrium.

☐ Collaborative Governance

The executive-legislature relationship in budgeting exemplifies a combination of collaboration and control. The executive leads the formulation and execution of budget policies, while the legislature ensures accountability and legitimacy within a democratic framework. Together, they protect public resources, enhance transparency, and fortify the principles of democratic governance.

☐ Budgetary Challenges

1.3.6. Issues and Challenges in Budgetary Control

Budgetary control plays a crucial role in financial management, ensuring public funds are utilized efficiently, transparently, and in alignment with approved plans that serve the public interest. However, numerous challenges hinder its effective implementation. These challenges stem from political, administrative, economic, and technical factors that often limit the capacity of legislative bodies and other institutions to maintain robust financial oversight.



☐ Executive Dominance

A significant issue is the dominance of the executive in the budgeting process. The executive branch generally possesses greater access to critical information, technical expertise, and administrative resources. As a result, legislatures are frequently reliant on the executive for budget-related data and analyses, creating an imbalance of power. This asymmetry hampers the ability of legislative bodies to thoroughly evaluate budget proposals, leading to situations where budgets are often approved with minimal modifications. Another pressing challenge is the limited time allocated for legislative scrutiny. Budgets are typically extensive and intricate documents containing financial forecasts and policy plans. Legislators, operating under tight schedules, are often compelled to assess these documents hastily. Consequently, in-depth analysis and meaningful debate are constrained, with many proposals passing without adequate examination.

☐ Technical Complexity

The technical nature of modern budgets poses its own set of difficulties. Budgets today incorporate complex elements like economic forecasts, fiscal deficit calculations, revenue projections, and exhaustive financial data. A significant portion of legislators may lack the specialized financial or economic expertise needed to fully grasp such intricacies. This expertise gap further undermines effective oversight. Political dynamics also play a pivotal role in weakening budgetary control. In party-centric parliamentary systems, members of ruling parties tend to support government budgets without question due to party discipline and adherence to the whip system. This limits the independence of legislative scrutiny and curtails opportunities for constructive criticism.

☐ Committee Limitations

An additional concern lies in the underperformance of legislative committees in certain systems. Committees like the Public Accounts Committee or Estimates Committee are intended to strengthen financial monitoring. However, these bodies may face hurdles such as inadequate expert support, resource constraints, or delays in report examination. In some cases, their recommendations may not be effectively implemented by the executive, further diluting their impact. Another challenge is the lack of transparency in financial administration. When budget documents are presented with dense language or heavy technical jargon, it becomes difficult for both legislators and the general public to comprehend government expenditures fully. This obscurity undermines accountability and erodes trust in the process.

☐ Corruption & Uncertainty

Corruption and misuse of funds exacerbate issues related to budgetary control. Instances of fund misallocation or project inflation for personal or political gain erode public trust and violate fiscal responsibility. These issues are often compounded by weak monitoring systems and lax enforcement mechanisms. Economic uncertainty also complicates effective budget management. Unforeseen events such as financial crises, natural disasters, or global economic disruptions can force significant revisions to budgets mid-year. Such uncertainties challenge governments' ability to adhere strictly to their original financial plans.

☐ Reform Measures

Another noteworthy issue is the limited involvement of citizens and civil society in budgeting processes. Budget discussions predominantly occur within government or legislative circles with minimal public engagement. Enhanced public participation would foster greater transparency and accountability but remains underutilized in many instances. Finally, delays in auditing and reporting can severely hinder post-budgetary oversight. Audit reports often arrive long after a financial period concludes, limiting their utility in addressing irregularities or improving future processes. Timely audit and reporting practices are essential for strong financial governance. Despite these obstacles, there are actionable steps that can significantly enhance budgetary control. Initiatives such as strengthening legislative committees, offering specialized financial training to lawmakers, promoting transparency, engaging citizens more actively, and leveraging modern technology can collectively improve oversight efficiency.

In conclusion, budgetary control is an indispensable element of good governance, several challenges—ranging from executive dominance and technical complexity to political pressures and inadequate public participation—complicate the process. Addressing these issues is essential to ensure that public funds are managed responsibly and transparently for the benefit of society at large.

Summarised Overview

The budget is the most important financial statement of a government, reflecting its priorities, policies, and development goals. The process of budgeting involves a close interaction between the Executive, which prepares and implements the budget, and the Legislature, which examines, approves, and monitors it. This cooperation ensures accountability, transparency, and democratic control over public finances.

The Executive plays the primary and dominant role in the budgeting process. It is responsible for budget formulation, where ministries and departments estimate their financial needs and submit proposals to the finance ministry. The executive evaluates these proposals, sets priorities, and prepares the draft budget based on economic conditions, revenue forecasts, and policy goals. After preparation, the executive presents the budget to the legislature and later carries out budget execution by collecting revenues, spending funds, and managing public programs. During implementation, the executive also ensures financial discipline, efficient use of resources, and adherence to the approved allocations.

The Legislature acts as the guardian of public finance and represents the interests of citizens. Its key role begins after the budget is presented. It debates, scrutinizes, and approves the budget, ensuring that government spending aligns with public needs and national priorities. Through discussions, voting on demands for grants, and passing the Appropriation and Finance Bills, the legislature authorizes the executive to raise and spend public money. This stage provides transparency and democratic legitimacy to the budget.

The legislature's role continues even after approval. Through questions, debates, audits, and committees such as the Public Accounts Committee and Estimates Committee, it monitors budget execution and ensures accountability. This oversight prevents misuse of funds and promotes financial responsibility.

The budgeting process requires cooperation between the executive and legislature. While the executive brings expertise and administrative capacity, the legislature provides democratic control and scrutiny. Together, they maintain a balance between efficiency and accountability in public financial management.

Self-Assessment Questions

1. Political as well as administrative process?
2. Explain the role of the Executive in budget formulation. What are the main stages involved in preparing the budget?
3. How does the Executive ensure coordination among different ministries and departments during budget preparation?
4. Describe the process of budget presentation in the legislature. Why is this stage important for transparency?
5. What are the main powers of the Legislature in the approval of the budget?
6. Differentiate between Demand for Grants, Appropriation Bill, and Finance Bill.
7. How does the Legislature exercise control over public expenditure after the budget is passed?
8. Explain the role of legislative committees such as the Public Accounts Committee (PAC) and Estimates Committee in financial accountability.
9. Why is the relationship between the Executive and Legislature important for effective budget implementation?
10. What are the major challenges faced by the Legislature in exercising control over the Executive in budget matters?

Assignment

1. Explain in detail the role of the Executive in budget formulation, presentation, and execution. How does it influence national economic priorities?
2. Discuss the powers and functions of the Legislature in the approval and control of the budget. Why is legislative scrutiny essential in a democracy?
3. Examine the relationship between the Executive and Legislature in the budgeting process. How does this relationship ensure accountability and efficiency?
4. Analyse the importance of legislative committees such as the Public Accounts Committee and Estimates Committee in financial control.
5. Critically evaluate the challenges faced by the Legislature in exercising effective control over the Executive in budgetary matters.
6. "Budgeting is a joint responsibility of the Executive and Legislature." Discuss this statement with suitable examples.



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Suggested Reading

1. Burkhead, Jesse (1956). Government Budgeting. John Wiley & Sons.
2. Chauhan, M.S. (2011). Public Finance – Issues and Problems. Global Publications.

Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

SGOU



BLOCK 2

Advanced Topics in Financial Administration

UNIT 1

Sources of Public Revenue

Learning Outcomes

Upon completion of this unit, learners will be able to:

- understand the fundamental sources of public revenue and their critical role in state-building and governance.
- explain the core principles of taxation and their impact on social equity.
- differentiate between various tax and non-tax revenue sources.
- analyse the constitutional framework of fiscal federalism in India, particularly the division of taxation powers.

Background

Public revenue forms the financial base of government functioning. The ability of the state to perform its duties, ranging from administration to welfare and development, depends on the availability of adequate financial resources. In a modern state, revenue is not just about raising money but also about ensuring fairness in distribution and supporting economic and social objectives.

Governments collect revenue from various sources such as taxes, fees, fines, tariffs, and income from public enterprises and natural resources. These funds are used to build infrastructure, provide education and healthcare, maintain law and order, and run welfare programmes. Thus, the way revenue is mobilised and utilised plays a key role in ensuring stability, development, and public trust in governance.



Keywords

Public Revenue, Tax Revenue, Non-Tax Revenue, Direct Taxes, Indirect Taxes, Goods and Services Tax (GST), Fiscal Federalism, Progressive Taxation, Public Finance

Discussion

Public revenue is essential for any government. Without sufficient funds, the state cannot fulfil its basic duties or meet the needs of its people. Everything from running the government to providing welfare and supporting development relies on having funds. How revenue is collected also shows how fair the system is, how resources are shared, and what role the government plays in society and the economy.

In simple terms, public revenue is the money the government collects from various sources to meet its expenses. These sources include taxes, fees, fines, tariffs, money from natural resources, and profits from government businesses. This income lets the government build infrastructure, support education and healthcare, keep the country safe, and run welfare programs. So, the way revenue is collected and spent is key to stability and development. Public revenue is the total money the government collects to pay for its work. It provides the government with the funds it needs to fulfil its economic and social duties. Besides funding, public revenue also affects how resources are shared in society and how the economy is managed.

Governments use public revenue for many purposes. This includes building roads and other infrastructure, providing education and healthcare, keeping law and order, and protecting the country. Public revenue also funds welfare programs to help those in need. In this way, it shapes both economic growth and social well-being, including both direct taxes on income and indirect taxes on goods and services. In addition to taxes, governments collect revenue through service charges, penalties, customs duties, and income from public assets and enterprises. Having multiple sources helps the government maintain a steady flow of income and reduces the risks of relying on a single source.

Overall, the effectiveness of a revenue system depends not only on how much is collected but also on how fairly and

efficiently it is managed. A well-organised system supports development and builds public trust, while weaknesses in revenue collection can lead to financial strain and unequal distribution of resources.

2.1.1. Meaning and Significance of Public Revenue

Public revenue is the money the government collects from different sources to pay for its expenses and carry out its duties. This includes money from taxes, fees, fines, profits from government businesses, and similar sources. Hugh Dalton, in *Principles of Public Finance*, described public revenue as the income the state needs to carry out its functions and provide public services. Bastable also said that public revenue is the money needed to cover government spending and keep government activities running. These definitions show that public revenue is a system the state uses to meet society's needs. The importance of public revenue has grown as governments take on more responsibilities. S. N. Chand, in *Public Finance*, explains that as government roles have expanded, raising sufficient revenue has become more complex and necessary. Today, governments are involved in economic planning, social welfare, and development programs. Without enough revenue, these activities cannot be carried out effectively.

Public revenue is needed to fund essential areas such as infrastructure, education, healthcare, and social security. It helps the government work on long-term development and respond to urgent social needs. Public revenue also funds essential services, such as law and order, defence, and administration, which are important for political stability.

Besides its financial role, public revenue is also an important tool for economic policy. R. K. Gupta and P. K. Saini, in *Financial Administration in India*, explain that revenue policies, especially taxes, can affect how people save, invest, and spend. For example, progressive taxes are often used to reduce income inequality, while indirect taxes can control demand for certain products. The way a government collects revenue also shows its priorities and values. A good revenue system is fair and helps the economy grow. On the other hand, poor revenue collection can lead to budget problems, weak public services, and more inequality. This makes public revenue key to understanding how the government, economy, and society are connected.



2.1.2. Characteristics of Public Revenue

Public revenue has unique features that distinguish it from private income and highlight its role in governance.

1. Compulsory Nature of Major Sources

A large part of public revenue, especially taxation, is compulsory. Citizens are legally required to pay taxes without expecting any direct or immediate return from the government. As pointed out in I. M. Pandey's Financial Management, this compulsory element distinguishes public revenue from voluntary payments in the private sphere.

2. Public Purpose

Public revenue is collected for the common good rather than for individual benefit. The funds are used to finance services and activities that serve society as a whole, such as infrastructure, defence, and welfare programmes. This collective purpose is a defining feature of government income.

3. Diverse Sources

Public revenue is drawn from multiple sources, including direct and indirect taxes, fees, fines, and income from public enterprises. S. K. Mahajan notes that this diversity helps ensure stability in government finances and reduces dependence on a single source of income.

1. Non-Quid Pro Quo Nature

In most cases, particularly taxation, there is no direct relationship between payment and benefit. A taxpayer may not receive a specific service in proportion to the tax paid. This absence of direct exchange distinguishes public revenue from market transactions.

2. Instrument of Economic and Social Policy

Public revenue is not merely financial; it is also a tool for achieving policy objectives. Governments use taxation and other revenue measures to influence economic behaviour, control inflation, and promote social justice.

3. Legal Sanction and Authority

All forms of public revenue are collected under the authority

of law. In the Indian context, this principle is reflected in the constitutional provision itself that no tax shall be levied or collected except by authority of law. This ensures accountability and protects citizens from arbitrary exactions.

The characteristics of public revenue highlight its unique position as a collective resource, shaped by legal authority and directed towards public welfare. Its nature and structure reveal how the state interacts with society and manages its economic responsibilities.

2.1.3. Sources of Public Revenue

Public revenue comes from various sources, reflecting the state's economic structure and policy goals. These sources are usually grouped into tax revenue and non-tax revenue. Together, they form the financial base for government work. According to S. K. Mahajan's Financial Administration in India, using both types in balance helps keep public finances stable, adequate, and flexible.

2.1.3.1. Tax Revenue

Tax revenue is the main and most dependable source of public income. It includes payments that the state requires from people and businesses, without giving anything in return. Taxes are generally split into two types:

- **Direct Taxes:** These are charged straight to individuals and organisations, and the responsibility to pay cannot be passed on to others. Examples are income tax, corporate tax, and capital gains tax. Direct taxes are usually based on how much someone can afford to pay and help with redistributing wealth.
- **Indirect Taxes:** These are placed on goods and services, and in the end, consumers pay for them. Examples are Goods and Services Tax (GST), customs duties, and excise duties. These taxes are easier to collect and reach more people, but they can be unfair to lower-income groups if not well planned.

Tax revenue matters because it provides the government with a steady source of income and enables it to shape economic choices and support social fairness.



2.1.3.2. Non-Tax Revenue

Non-tax revenue is all the money the government receives that does not come from taxes. While these sources are usually smaller than tax revenue, they still play an important supporting role.

- **Fees and User Charges:** Collected for specific services provided by the government, such as licensing, education, and public utilities.
- **Fines and Penalties:** Imposed for violations of laws and regulations.
- **Income from Public Enterprises:** Profits and dividends earned from government-owned companies.
- **Interest Receipts:** Earnings from loans given by the government to individuals, institutions, or other governments.
- **Grants and Aid:** Financial assistance received from other governments or international organisations.
- **Income from Natural Resources:** Revenue generated from resources such as minerals, oil, and forests.

As S. N. Chand points out, non-tax revenue shows that the government is not just a ruler but also provides services and takes part in the economy.

2.1.4. Types of Taxes

Taxes constitute the most significant and stable source of government revenue. Broadly, they are classified into direct and indirect taxes, based on the manner in which they are imposed and borne.

Direct Taxes

Direct taxes are those levied directly on individuals and organisations, where the liability to pay the tax and the burden of payment fall on the same entity. These taxes are progressive in nature and reflect the taxpayer's ability to pay. The major forms of direct taxation in India include:

- **Personal Income Tax:** Levied on individual incomes

based on annual earnings, following a slab system that incorporates considerations such as age and disability.

- **Corporate Tax:** Imposed on the profits of domestic and foreign companies operating in India.
- **Capital Gains Tax:** Charged on the profits arising from the sale or transfer of capital assets such as property, shares, or bonds.
- **Estate or Inheritance Tax:** Though presently not in operation in India, this tax was historically levied on wealth or property transferred after a person's death in some jurisdictions.

Direct taxes serve not only as an instrument for revenue generation but also as a means of redistributing wealth and curbing inflationary trends.

Indirect Taxes and the Goods and Services Tax (GST)

Indirect taxes are levied on goods and services rather than on income or wealth. The burden of payment is ultimately passed on to the consumer, though the tax is collected by intermediaries such as manufacturers or retailers.

☐ "one nation, one tax, one market."

Since July 1, 2017, the indirect tax landscape in India has undergone a historic transformation with the introduction of the Goods and Services Tax (GST) under the 101st Constitutional Amendment Act, 2016. The GST replaced a complex structure of multiple indirect taxes, such as excise duty, VAT, and service tax, with a unified, technology-driven system adhering to the principle of "one nation, one tax, one market."

The GST is a multi-stage, destination-based tax levied on every value addition in the supply chain. It operates on a dual model, with the Centre and the States sharing taxing powers through Central GST (CGST), State GST (SGST), and Integrated GST (IGST) for inter-state transactions. The system promotes cooperative federalism, transparency, and efficiency in tax administration.

Advantages of GST

- **For Government:** It promotes a unified national market, curbs tax evasion through digital monitoring, and



enhances compliance through harmonised procedures.

- **For Trade and Industry:** It simplifies the tax structure, reduces cascading effects, lowers compliance costs, and improves export competitiveness.
- **For Consumers:** It increases price transparency, reduces the overall tax burden on goods and services, and encourages consumption-led growth.
- **For States:** It expands the tax base by including services, enhances revenue autonomy, and ensures a fairer distribution of resources through a destination-based model.

The implementation of GST represents one of India's most significant fiscal reforms, enabling greater fiscal integration, enhancing the ease of doing business, and strengthening the overall framework of tax governance.

Progressive, Proportional, and Regressive Taxation

Tax systems can also be classified according to the distribution of the tax burden among different income groups:

- **Progressive Taxation:** The rate of tax increases with the level of income, ensuring that the wealthy contribute a higher share of their earnings. This approach promotes equity and social justice.
- **Proportional Taxation:** A uniform tax rate is applied across all income levels, maintaining neutrality but offering limited redistributive benefits.
- **Regressive Taxation:** The rate of tax decreases as income rises, placing a relatively heavier burden on the poor. Certain indirect taxes may have regressive effects if not designed carefully.

A balanced fiscal system seeks to combine these approaches judiciously to achieve both revenue adequacy and distributive justice.

2.1.5. Constitutional Framework of Taxation in India

The authority to levy taxes in India is derived from the

❑ Introduction of GST

Constitution of India, which establishes a detailed framework for fiscal federalism. Article 265 lays down the fundamental principle that "no tax shall be levied or collected except by authority of law." This ensures that taxation is based on legislative sanction and not executive discretion.

The Seventh Schedule of the Constitution distributes taxing powers between the Union and the States through three lists:

- **Union List (List I):** Empowers the Parliament to levy taxes on income (except agricultural income), customs duties, excise duties, corporation tax, and service tax (now subsumed under GST).
- **State List (List II):** Grants States the power to levy taxes on agricultural income, land revenue, excise on alcoholic liquor, stamp duties, and taxes on vehicles, electricity, and entertainment.
- **Concurrent List (List III):** Does not include taxing powers, as taxation is considered an exclusive function of either the Union or the States.

The introduction of GST through the 101st Constitutional Amendment significantly restructured this division by establishing concurrent taxing powers on the supply of goods and services for both levels of government, thereby reinforcing the principle of cooperative fiscal federalism.

In short, a well-designed taxation system not only ensures adequate resource mobilisation for governance but also acts as a powerful instrument for equity, efficiency, and economic stability. The evolution from multiple tax regimes to a unified GST framework marks India's transition towards a modern, transparent, and technology-enabled fiscal structure.

2.1.6. Institutional Structure: CBDT, CBIC, and GST Council

An efficient and transparent tax administration is vital to ensuring fiscal discipline and sustaining public finance in any modern economy. In India, the Administration of taxes is institutionally divided between two key statutory authorities under the Department of Revenue, Ministry of Finance: the Central Board of Direct Taxes (CBDT) and the Central Board of Indirect Taxes and Customs (CBIC). These two



Central Board of Direct Taxes (CBDT)

□ Bifurcation of CBDT

❑ Composition of CBDT

❑ Key functions of the CBDT

The Central Board of Indirect Taxes and Customs (CBIC),

❑ Responsibilities of CBIC

formerly known as the Central Board of Excise and Customs (CBEC), was restructured in 2018 following the introduction of the Goods and Services Tax (GST). The CBIC is responsible for formulating and administering policies related to the levy and collection of customs duties, central excise, and GST (including CGST and IGST). It also manages anti-smuggling operations, trade facilitation, and enforcement of customs and border control regulations.

❑ Composition of CBIC

The Board is headed by a Chairperson and includes six Members, each in charge of key domains such as Customs, GST and Tax Policy, Legal Affairs, Administration and Vigilance, Investigation, and Information Technology & Taxpayer Services. The CBIC supervises an extensive field network comprising Customs Houses, Central Excise and GST Commissionerates, and the Central Revenues Control Laboratory.

❑ Vision

The CBIC's vision is to promote India's socio-economic growth through progressive indirect tax policies and trade facilitation, ensuring a fair, transparent, and technology-driven system of tax administration. Its mission emphasises simplicity, predictability, and fairness in tax enforcement while safeguarding the rights of taxpayers and encouraging voluntary compliance.

❑ Functional responsibilities

The functional responsibilities of the CBIC include the collection of customs and GST revenues, administration of refunds and drawbacks, facilitation of trade through customs clearance at ports and airports, prevention of smuggling, and risk-based enforcement for cargo and passenger movement. The CBIC also manages electronic communication systems for tax filing, return processing, and grievance redressal. With the introduction of digitised tax platforms such as ICEGATE for customs and GSTN for GST operations, the CBIC has embraced e-governance to enhance efficiency, reduce corruption, and ensure timely delivery of taxpayer services.

❑ Constitutional body established under Article 279A

2.1.8. Goods and Services Tax (GST) Council

The introduction of the Goods and Services Tax (GST) marked a watershed moment in India's fiscal federalism by integrating multiple indirect taxes into a unified system. The GST Council, a constitutional body established under Article 279A, serves as the institutional mechanism for cooperative fiscal governance between the Union and the States. It is mandated to make recommendations on key aspects of GST,



including tax rates, exemptions, model laws, and principles governing the apportionment of revenue between the Centre and the States.

❑ Composition of GST Council

The GST Council is chaired by the Union Finance Minister, with the Union Minister of State for Finance or Revenue as a member, and the Finance or Taxation Ministers of all States and Union Territories as representatives. The Revenue Secretary serves as the ex-officio Secretary, and the Chairperson of the CBIC is a permanent non-voting invitee. The Council Secretariat, funded by the central government, functions as the administrative and coordinating arm, staffed by officers on deputation from both central and state governments.

❑ Role

The Council's deliberations ensure that decisions on tax rates, exemptions, and procedural reforms are reached through consensus, reflecting the spirit of federal cooperation. It has played a crucial role in rationalising GST rates, simplifying return-filing procedures, and introducing technology-based compliance systems. However, aligning the interests of multiple stakeholders, including the states, is essential for improving fiscal federalism, balancing the revenue interests of the Centre and the States while maintaining the overall integrity of the indirect tax system.

Procedures for Assessment, Collection, and Enforcement

The efficiency of tax administration rests not only on institutional structures but also on the procedures for assessment, collection, and enforcement. Tax assessment involves determining the tax liability of individuals and entities based on their income or transactions, as per statutory provisions. With digitisation, the Income Tax Department and CBIC have adopted automated and faceless systems of assessment to enhance transparency and minimise human discretion.

❑ Electronic payment gateways

Tax collection is facilitated through electronic payment gateways and integrated management systems such as TAXNET, ICEGATE, and GSTN, ensuring real-time monitoring of revenues. Enforcement measures, including audits, investigations, and penalties, are undertaken to ensure compliance and deter tax evasion. Legal provisions empower authorities to impose penalties, initiate prosecution, and recover dues in cases of non-compliance. The modern enforcement approach emphasises risk-based monitoring and data analytics to detect irregularities while minimising harassment to compliant taxpayers.

Tax Reforms and Digitisation

❑ Modernisation of tax regime

Over the past few decades, India's tax administration has undergone significant transformation, driven by reform, simplification, and digitisation. The introduction of Permanent Account Number (PAN), Tax Information Network (TIN), e-filing of returns, faceless assessments, and digital refund systems has modernised the direct tax regime. Similarly, the rollout of GST and the integration of GSTN have revolutionised indirect taxation by enabling seamless input tax credit and real-time tax reconciliation.

❑ Importance of Digitalisation

Digitisation has enhanced efficiency, accountability, and taxpayer convenience while curbing leakages and corruption. Initiatives like the Income Tax Business Application (ITBA), Automated Refund Management System (ARMS), and Analytics-based Compliance Management reflect the government's commitment to data-driven tax governance. Tax reforms continue to focus on expanding the tax base, improving compliance through simplification, and aligning India's fiscal policies with global best practices.

❑ Fiscal sustainability and Non tax revenue

2.1.9. Non-Tax Revenue

While taxation constitutes the principal source of public revenue, governments also mobilise significant resources through non-tax revenues. Non-tax revenue refers to all receipts of the government that are not generated through the imposition of taxes but arise from the ownership of property, rendering of services, or exercise of sovereign and regulatory functions. These revenues supplement tax receipts and play a vital role in ensuring fiscal stability, especially in times of economic slowdown when tax collections may decline. In modern public finance, non-tax revenues are increasingly recognised for their contribution to fiscal sustainability, efficiency in service delivery, and economic governance.

❑ Include fees, fines, penalties

2.1.9.1. Components of Non-Tax Revenue

The components of non-tax revenue are diverse and reflect the multifaceted nature of government functions. Broadly, they include fees, fines, penalties, income from property and enterprises, interest receipts, grants and aid, and seigniorage. Each of these elements contributes to the government's income in distinct ways and carries unique economic implications.



Governments levy fees for rendering specific administrative, social, or economic services to citizens. Examples include fees for issuing passports, driving licences, registration of properties and vehicles, educational certificates, or licences for industrial and commercial activities. Such fees ensure that those who directly benefit from public services contribute proportionately to their cost, thereby promoting efficiency and discouraging overuse.

- User charges, on the other hand, are collected for the use of public utilities such as water supply, electricity, postal services, transport, and sanitation. Ideally, these charges should reflect the cost of providing the service, ensuring economic rationality and efficient resource utilisation. In some cases, cross-subsidisation mechanisms are adopted to ensure access for economically weaker sections, thereby balancing equity and efficiency considerations in public service delivery.

Governments often earn property income from assets such as land, buildings, and natural resources. Rentals from government buildings, tolls on roads and bridges, and royalties from the extraction of minerals, oil, and natural gas are significant sources of revenue. In addition, governments derive income from public sector undertakings (PSUs) through dividends and profits, as well as from interest earned on loans extended to employees, other governments, or public institutions. These revenues, while not as stable as taxes, provide an important supplement to fiscal resources and reflect the productive utilisation of public assets.

- ### 3. Fines and Penalties

Fines and penalties are monetary sanctions imposed for violations of laws or regulations, such as traffic offences, evasion of customs duties, or breaches of environmental norms. Although the primary purpose of fines is deterrence rather than revenue generation, they contribute modestly to government income. Economists often view fines as instruments of behavioural regulation, ensuring social discipline and reinforcing the rule of law. Some countries adopt the "day-fine" approach, linking fines to daily income to maintain proportionality and fairness.

- ## 4. Grants and Aid

Grants and aid are transfer payments received by a

- ❑ Policy conditions that influence domestic priorities

government from higher levels of domestic government, foreign governments, or international organisations such as the World Bank, IMF, or UN agencies. These transfers may be unconditional or tied to specific projects or policy objectives. While grants augment the recipient's financial capacity, they may sometimes carry policy conditions that influence domestic priorities. In the Indian context, central assistance to states and foreign aid for development projects play an important role in supporting infrastructure, health, and education sectors.

5. Seigniorage and Fiscal Services

- ❑ A form of implicit revenue

Seigniorage refers to the profit earned by the government from issuing currency, specifically the difference between the face value of money and the cost of printing or minting it. This source, though relatively minor in scale, has fiscal implications, as it provides a form of implicit revenue to the central government through the operations of the Reserve Bank of India. Seigniorage is sometimes described as a "silent tax," as it can contribute to inflation if used excessively for deficit financing.

Governments also provide fiscal services such as the production of currency notes, stamps, and security papers, which generate additional non-tax revenue. These activities, while technical in nature, are integral to the financial sovereignty of the state.

2.1.10. Role of Non-Tax Revenue in Budgetary Management

- ❑ Diversify the sources of government income

Non-tax revenues contribute significantly to the stability and flexibility of budgetary management. They diversify the sources of government income, thereby reducing excessive dependence on taxation. By providing regular cash inflows from administrative fees, dividends, and interest, they help bridge fiscal gaps and sustain essential public services. Moreover, the principle of cost recovery embedded in user charges ensures efficient allocation of public resources and discourages wasteful consumption.

In macroeconomic terms, a healthy stream of non-tax revenues supports fiscal consolidation efforts and helps governments maintain prudent deficit levels. In India, revenues from public sector enterprises, royalties from natural resources, and dividends from the Reserve Bank of India constitute a substantial share of the Union Government's non-tax receipts. At the state level, user charges for utilities, land revenues, and fees

from administrative services form crucial sources of income. Thus, effective management of non-tax revenue enhances fiscal autonomy and contributes to the overall credibility of budgetary processes.

Sources and Significance in the Indian Context

In the Indian fiscal system, non-tax revenue has historically played a complementary role to taxation. Major sources include dividends from PSUs, interest receipts, royalties from the petroleum and mining sectors, spectrum fees from telecommunications, and service charges from railways and postal services. Grants from the central government and international development partners also constitute important components at both Union and State levels.

☐ Significance of non-tax revenue

The significance of non-tax revenue in India extends beyond mere fiscal supplementation. It reflects the efficiency of public sector performance, the effectiveness of regulatory institutions, and the commitment to user-based financing of public goods. Reforms aimed at rationalising user charges, improving financial management in PSUs, and enhancing transparency in royalty and licensing systems have become central to India's fiscal modernisation agenda. In this context, non-tax revenues are not merely auxiliary receipts but vital instruments for achieving fiscal sustainability, accountability, and economic efficiency in governance.

2.1.11 Challenges in Revenue Collection and Management

☐ Structural and administrative constraints

Revenue collection and management form the backbone of public finance and effective governance. However, several challenges undermine the efficiency, transparency, and equity of India's fiscal system. These challenges range from structural and administrative constraints to issues of policy inconsistency and intergovernmental fiscal imbalance. Addressing them requires not only institutional reform but also the use of modern technology, data analytics, and participatory approaches to ensure fiscal sustainability and public trust.

Tax Evasion and Avoidance

One of the most persistent challenges in India's revenue system is tax evasion and avoidance. Despite improvements in tax administration and the introduction of digital monitoring systems, a significant portion of potential tax revenue remains uncollected due to underreporting, concealment of income, and

- ❑ Use of loopholes in tax laws

the use of loopholes in tax laws. Tax evasion erodes the revenue base, distorts equity, and shifts the burden onto compliant taxpayers. Avoidance through legal loopholes, aggressive tax planning, and offshore arrangements by corporations further complicates the issue. The government has responded through measures such as the introduction of the Goods and Services Tax (GST), Direct Tax Code reforms, and international cooperation for information exchange; yet, the gap between potential and actual tax collection remains substantial, indicating the need for a stronger enforcement and compliance culture.

Administrative Inefficiency and Corruption

- ❑ Persistence of informal practices and bureaucratic rigidity

Administrative inefficiency and corruption are equally critical challenges affecting the integrity of revenue management. The complexity of tax laws, inadequate capacity of personnel, and procedural delays often result in inefficiencies in assessment, collection, and auditing. Corruption in revenue departments not only causes a direct loss of funds but also erodes citizens' confidence in fiscal institutions. Although digitisation initiatives such as e-filing, faceless assessment, and online grievance redressal have enhanced transparency, the persistence of informal practices and bureaucratic rigidity continues to limit the effectiveness of reforms. Building institutional capacity, promoting ethical conduct among revenue officials, and adopting data-driven decision-making systems are essential to ensuring accountable and efficient revenue administration.

Fiscal Imbalance between Centre and States

- ❑ Challenges form federal strcture

India's federal structure poses unique challenges in maintaining fiscal balance between the Centre and the States. While the Centre enjoys dominant taxing powers, States are responsible for critical sectors such as health, education, and infrastructure, which require substantial financial resources. This vertical imbalance often leads to an over-dependence of States on central transfers through Finance Commissions and centrally sponsored schemes. Horizontal imbalances among States, arising from differences in resource endowments and administrative capacities, further complicate fiscal federalism. Although mechanisms like the Finance Commission, GST Council, and devolution formulae aim to correct these disparities, tensions over revenue sharing and fiscal autonomy continue to surface, particularly after the introduction of GST, which subsumed several State taxes.

- ❑ Need for institutional reforms

Summarised Overview

The structure of public revenue reflects the broader goals of governance, including economic development, social justice, and stability. Principles of taxation ensure fairness and efficiency, while a diversified revenue system helps maintain consistency in income generation. At the same time, challenges such as inefficiency, inequality, and fiscal imbalances highlight the need for better management and reform.

Self-Assessment Questions

1. What is meant by public revenue? Explain its importance in governance.
2. Identify the major sources of public revenue.
3. Distinguish between direct and indirect taxes with examples.
4. Explain the main characteristics of public revenue.
5. What are the components of non-tax revenue?
6. Discuss the role of taxation in promoting social equity.
7. Explain the significance of GST in India's revenue system.
8. How does public revenue influence economic development?
9. What are the major challenges in mobilising public revenue?
10. Why is diversification of revenue sources important?

Assignment

1. Examine the concept and significance of public revenue in the context of modern governance.
2. Analyse the different sources of public revenue and their role in economic development.
3. Discuss the characteristics of public revenue and explain how they differ from private income.
4. Evaluate the role of tax and non-tax revenue in maintaining fiscal stability.
5. Critically assess the challenges in public revenue mobilisation and suggest suitable reforms.

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UNIT 2

Principles and types of public expenditure

Learning Outcomes

Upon completion of this unit, learners will be able to:

- understand the concept, nature, and scope of public expenditure in the context of modern governance.
- explain the changing role of public expenditure from a minimal state to a welfare-oriented state.
- analyse different classifications and types of public expenditure and their relevance in public finance.
- evaluate the importance of expenditure management in ensuring economic stability, fiscal discipline, and social justice.

Background

Public expenditure is an important part of financial administration because it shows how governments use resources to meet society's needs. Over the years, government spending has grown as the state's role has shifted from simply maintaining order to supporting welfare and development. Now, governments are expected to invest in areas such as education, healthcare, infrastructure, and social security, making public spending a primary means of achieving economic and social goals.

As government spending has grown, managing public expenditure has become more important. It is not enough to just spend money; the focus is now on ensuring spending is efficient, purposeful, and aligned with broader development goals. How public spending is planned, organised, and tracked is key to keeping budgets balanced and making sure resources are used wisely.

Keywords

Public Expenditure, Welfare State, Revenue Expenditure, Capital Expenditure, Developmental Expenditure, Non-Developmental Expenditure, Efficiency, Economy, Effectiveness

Discussion

Public expenditure refers to the money governments and their agencies spend to meet society's needs. This includes spending on administration, defence, public services, welfare programs, and development projects. Through public expenditure, the state meets its economic, social, and constitutional duties.

Public expenditure has changed a lot over time. In the past, governments mostly spent money on law and order, defence, and basic administration. With the rise of the welfare state, government spending now covers many more areas, including social welfare, economic planning, infrastructure development, and human resource development.

Public expenditure today covers diverse sectors, including education, healthcare, housing, rural and urban development, environmental protection, and industrial growth. This growth shows that citizens expect more from the government and that the state is committed to inclusive development. It also means that managing public spending has become more complex and important, including revenue and capital, developmental and non-developmental, and functional and economic forms. Public expenditure is divided into categories like revenue and capital, developmental and non-developmental, and functional and economic. These categories help people understand how government spending works and what effects it has. They also make it easier to plan, monitor, and evaluate spending. So, public expenditure is more than just spending money. It is a planned activity that aims to support economic stability, social justice, and sustainable development.

❑ Spending incurred by the government and its agencies

2.2.1. Meaning, Nature, and Scope

Public expenditure refers to the spending incurred by the government and its agencies to meet society's collective needs and promote the overall economic and social welfare of citizens. It includes all expenditures by the central, state, and



local governments on activities such as administration, defence, education, health, infrastructure, and welfare programmes. In essence, public expenditure is a vital instrument through which the state seeks to fulfil its constitutional and developmental responsibilities toward its people.

❑ Transformation in the nature of public expenditure

The nature of public expenditure has undergone a significant transformation over time. In earlier periods, government spending was limited primarily to maintaining law and order, ensuring internal and external security, and administering justice. However, with the advent of modern welfare states, the scope of public expenditure has expanded enormously to include a wide range of economic, social, and developmental activities. Today, it covers sectors such as education, public health, housing, rural and urban development, industrial promotion, environmental conservation, and social security.

Public expenditure can be classified in various ways, such as revenue and capital expenditure, developmental and non-developmental expenditure, or plan and non-plan expenditure (in earlier Indian budgets). Each of these categories plays a distinct role in achieving macroeconomic stability, promoting equity, and facilitating sustainable growth.

2.2.1.2 Importance of Expenditure Management in Public Finance

❑ Reflects the increasing expectations of citizens

In modern economies, the magnitude of government spending has been rising steadily due to the expanding role of the state in socio-economic development. The growth of public expenditure reflects the increasing expectations of citizens and the state's commitment to welfare, equity, and inclusive growth. However, with this expansion comes the critical need for efficient management of public expenditure to ensure that public resources are used judiciously and effectively.

Sound expenditure management is essential for several reasons:

1. **Economic Stability:** Government spending influences the level of aggregate demand, employment, and income in the economy. Effective management of expenditure helps maintain economic stability and control inflation or deflation.
2. **Fiscal Discipline:** Uncontrolled expenditure may lead to fiscal imbalances and unsustainable public debt. Prudent

management ensures fiscal responsibility and macroeconomic stability.

3. Resource Allocation: Through expenditure policy, the state can direct resources toward priority sectors such as education, health, and infrastructure, promoting equitable and balanced development.
4. Social Justice: Expenditure management ensures that funds are utilised to reduce inequalities, protect vulnerable sections, and promote social inclusion.
5. Accountability and Transparency: Proper planning, execution, and auditing of expenditure enhance the accountability of public institutions and foster trust in governance.

2.2.2 Classical and Modern Views on Public Expenditure

Classical economists such as Adam Smith, J.B. Say, and Sir Parnell viewed government expenditure with scepticism. They believed in the doctrine of *laissez-faire* and advocated minimal state intervention in economic activities. According to them, the role of the state should be confined to the maintenance of law and order, defence, and justice.

- Adam Smith emphasised that the government should limit its functions to security, justice, and certain essential public works.
- J.B. Say famously remarked, "The best of all plans of finance is to spend less," reflecting the belief that government expenditure should be strictly limited.
- Similarly, Sir Parnell considered any expenditure beyond what was necessary for social order and defence as "wasteful and oppressive."

☐ Minimal state intervention

For classical thinkers, state activities were largely seen as unproductive, and excessive spending was viewed as an intrusion on individual economic freedom. In contrast, modern economists and policymakers regard public expenditure as an essential instrument for promoting welfare and development. The emergence of the welfare state in the 20th century transformed the philosophy of governance, from a minimal "police state" to an active "developmental state." Today, governments are expected not merely to maintain order



but also to promote social welfare, economic growth, and human development.

Contemporary public expenditure is directed toward diverse objectives, including:

- Ensuring national security and defence,
- Promoting social justice and protecting vulnerable and marginalised groups,
- Encouraging economic development and industrial growth,
- Establishing and maintaining public enterprises and infrastructure,
- Mitigating the impact of business cycles and economic crises,
- Providing relief and rehabilitation during natural disasters,
- Delivering public and administrative services, and
- Enhancing human capital through education, health, and social welfare programmes.

Thus, modern public expenditure is not merely a financial obligation but a powerful tool for shaping the nation's socio-economic destiny. Its effective management ensures that the objectives of growth, equity, and stability are realised in harmony with the principles of good governance.

2.2.3 Classification and Types of Public Expenditure

Government expenditure is classified in multiple ways to support financial control, promote economic development, and ensure better monitoring of public spending. Broadly, public expenditure can be grouped into four major classifications:

- (i) Functional or Budget Classification,
- (ii) Economic Classification,
- (iii) Cross Classification, and
- (iv) Accounting Classification.

Each of these serves a distinct administrative or developmental objective, helping policymakers assess how resources are allocated and how effectively they contribute to public welfare.

i) Functional or Budget Classification

❑ Lack of managerial focus

Traditionally, government accounts in India were organised according to the administrative unit responsible for the expenditure and the nature of inputs used. For example, the construction of a hospital was recorded under "Public Works" rather than under a functional category like "Medical Relief." While this system indicated the type of expenditure, it did not clarify its purpose or link spending to specific programmes, activities, or projects. As a result, it lacked managerial focus and made monitoring and evaluation difficult.

To address these limitations, the Government of India introduced a revised accounting framework in April 1974, which sought to strengthen both management and financial control. This system adopted a five-tier classification: sector, major head, minor head, subhead, and detailed head.

❑ Five-tier classification

- At the sectoral level, government activities are grouped into three broad sectors: General Services, Social and Community Services, and Economic Services.
- A major head represents a specific governmental function.
- A minor head corresponds to programmes within each function.
- Subheads classify activities, schemes, or organisations associated with each programme.
- Object classification, placed at the last tier, identifies item-wise expenditure to ensure precise financial control.

This restructuring created a strong connection between budget documents, accounts, and plan allocations. Functional classification now enables detailed monitoring of spending on functions, programmes, and activities, making it easier for administrators to assess progress and evaluate outcomes.

ii) Economic Classification

Economic classification focuses on categorising public expenditure according to its economic nature and impact. It distinguishes between current expenditure and capital outlays, spending on goods and services, and transfers to individuals and institutions. It also classifies government receipts into tax revenue, non-tax revenue, loans, grants, and other sources.



This system highlights critical aggregates such as:

- government consumption expenditure,
- public investment, and
- the extent to which public savings are utilised to finance development.

❑ Based on economic nature and impact

Economic classification is essential for understanding how government transactions influence various sectors of the economy. It provides a clear picture of the state's developmental priorities and helps assess the macroeconomic implications of fiscal policy.

iii) Cross Classification (Economic-cum-Functional Classification)

Cross classification combines the features of functional and economic classifications, offering a more holistic view of public expenditure. Under this system:

- Expenditure on a particular function, such as health services, is further divided into economic categories like current spending, capital expenditure, subsidies, or loans.
- Similarly, spending under an economic category, such as capital formation, is distributed across different functional areas like education, labour welfare, family planning, etc.

❑ Integration of economic and functional classification

By integrating both dimensions, cross classification enables detailed analysis of how economic resources are used across diverse public functions. It provides a comprehensive picture of government operations and helps evaluate the efficiency and distributional impact of expenditure.

iv) Accounting Classification

Accounting classification organises public expenditure in terms of its nature and purpose and traditionally included the categories:

- Revenue and Capital Expenditure,
- Developmental and Non-Developmental Expenditure, and
- Plan and Non-Plan Expenditure (now discontinued).

Overall, accounting classification continues to support financial discipline, clarify the nature of expenditure, and assist in framing policies related to budgeting and fiscal management.

2.2.4. Revenue and Capital Expenditure

Government expenditure is broadly classified into Revenue Expenditure and Capital Expenditure, primarily based on whether the spending leads to the creation of assets or reduction of liabilities. This distinction is central to fiscal management and is mandated by the Indian Constitution, which requires the budget to clearly separate revenue transactions from capital transactions.

Revenue Expenditure

Revenue expenditure refers to the recurring, day-to-day expenses required for the normal functioning of government departments and for the delivery of essential public services. These expenditures do not create assets, nor do they reduce existing liabilities. Instead, they support the government's routine administrative and welfare responsibilities.

Key components of revenue expenditure include:

- Salaries, pensions, and administrative expenses for departments such as police, judiciary, and external affairs.
- Interest payments on public debt, which form a major part of recurring expenditure.
- Subsidies on food, fertilisers, exports, and petroleum products, which help stabilise prices and support vulnerable groups.
- Grants-in-aid given to state governments, Union Territories, and other institutions, which are also treated as revenue expenditure.
- Social sector spending, such as education, health, social security, welfare programmes, and employment schemes, including the Mid-Day Meal Scheme, MGNREGA payments, and public health interventions.

Revenue expenditure generally covers goods and services consumed within the current accounting period (1 April to 31 March). It also forms part of the revenue budget, which consists of revenue receipts (tax and non-tax revenues) and the expenditure met from them.



Capital expenditure, in contrast, includes spending that creates durable assets or reduces existing liabilities. These expenditures contribute to the productive capacity of the economy and have long-term developmental significance.

- Productive capacity of the economy

- A key feature of capital expenditure is that major spending occurs at one point in time, while benefits are realised over many years. It forms part of the capital budget, which includes both capital receipts and capital payments. Capital receipts typically involve borrowings, market loans, loans from the RBI, Treasury Bills, and external loans.

Core Difference

- Revenue expenditure supports normal government functioning but does not result in asset creation.
- Capital expenditure leads to asset creation or liability reduction, thereby strengthening long-term developmental capacity.

Both categories are crucial for effective public financial management. Revenue expenditure ensures continuity of essential services, while capital expenditure builds the foundation for sustained economic growth.

2.2.5. Developmental and Non-Developmental Expenditure

A significant way of classifying government expenditure is based on its purpose and contribution to economic and social development. This distinction helps policymakers understand whether public spending is enhancing the productive and welfare capacities of the economy or merely sustaining essential state functions.

Developmental Expenditure

Developmental expenditure refers to public spending that directly promotes economic growth, social welfare, and human development. It includes expenditure on sectors such as:

❑ Public spending that directly promotes economic growth

- Agriculture and rural development
- Irrigation, cooperation, and labour and employment
- Industry, energy, transport, and communication
- Education, public health, family welfare, and science and technology
- Environmental protection and social/community services

This category includes expenditure incurred on both revenue and capital accounts, as long as spending contributes to building human capital, expanding productive capacity, or improving socio-economic conditions.

Developmental expenditure has evolved closely with the model of economic planning in India. It forms the core target of economic plans, allowing planners to set measurable goals in areas such as literacy, infrastructure, and agricultural productivity. By defining specific developmental outlays, governments can focus the economic aspirations of citizens toward long-term improvements.

Although developmental expenditure is generally seen as supporting progress, particularly in backward or underdeveloped regions, its effectiveness depends on context. Not all spending labelled "developmental" remains beneficial indefinitely; it must continue to contribute marginally and meaningfully to economic welfare.



Non-Developmental Expenditure

Non-Developmental Expenditure, in contrast, refers to spending on the general and administrative services of the state that do not directly accelerate economic growth but are vital for governance, stability, and national security. These include:

❑ Essential for maintaining order and sovereignty

- Defence services
- Police and internal security
- Interest payments on public debt
- Pensions and administrative costs
- Collection of taxes and duties
- Expenditure on constitutional bodies and civil administration

Such expenditure is essential for maintaining order, sovereignty, and the smooth functioning of government machinery. While traditionally viewed as not contributing to economic development, many components of non-developmental expenditure, such as administration, rehabilitation, or disaster relief, may indirectly support economic stability and growth.

Although the distinction between developmental and non-developmental expenditure provides a useful analytical framework, it is not always rigid:

- Some non-developmental expenditures (e.g., defence or administration) indirectly support economic progress by ensuring stability.
- Over-emphasis on increasing developmental expenditure at the cost of essential non-developmental services may lead to governance deficits and undermine long-term development.
- Both categories ultimately contribute to public welfare and must be assessed in terms of their marginal contribution to national objectives rather than their labels.

Significance of the Classification

This classification helps policymakers:

- Assess whether public spending priorities align with development goals.

- Ensure adequate investment in sectors that enhance productivity and welfare.
- Maintain a balance between development needs and essential administrative functions.

In essence, while developmental expenditure drives economic and social progress, non-developmental expenditure sustains the administrative and security framework within which development can occur. A balanced approach is therefore crucial for holistic development.

2.2.6. Plan and Non-Plan Expenditure

After Independence, India adopted a new classification of expenditure into Plan and Non-Plan heads. This distinction reflected the priorities of India's planning framework.

☐ Aligned with the targets of the Five-Year Plans

Plan Expenditure referred to the spending that was aligned with the objectives and targets of the Five-Year Plans. It included both revenue and capital expenditure on programmes and projects intended to promote long-term growth and development. Typical areas covered were agriculture, irrigation and flood control, rural development, energy, industry, transport, communication, science and technology, and social services. Plan expenditure also included central assistance to State and Union Territory plans, ensuring coordinated development across levels of government.

Non-Plan Expenditure, in contrast, comprised all other expenditures not related to plan schemes. These included defence, interest payments, pensions, subsidies, administrative services, police, postal deficits, and grants to States, Union Territories, and foreign countries. Non-Plan expenditure was further divided into Revenue and Capital components.

☐ Revenue and Capital heads

The earlier distinction between Plan and Non-Plan expenditure, though useful during the era of centralised planning, gradually became a source of confusion and inefficiency in evaluating government spending. It complicated the assessment of the quality, productivity, and long-term impact of expenditure, as funds were mechanically divided between plan schemes and routine administrative activities. Following the dismantling of the Planning Commission, this classification lost much of its rationale. Policymakers recognised that the plan–non-plan divide created a fragmented approach to resource allocation and blurred the link between financial outlays and actual outcomes in service delivery. Reflecting this concern, the



Rangarajan Committee (2011) also recommended abolishing this categorisation to improve fiscal clarity. Consequently, from 2017–18 onward, the Government of India formally discontinued the plan–non-plan distinction and reorganised expenditure under the more transparent and globally accepted categories of Revenue and Capital heads.

❑ Developmental and Non-developmental components

Under this revised system, government expenditure is now recorded under Revenue, Capital, and Loans, offering a clearer picture of how resources are being used. Revenue expenditure is further divided into Developmental and Non-developmental components, allowing for a more meaningful assessment of spending priorities. Alongside this structural reform, the government rationalised numerous Centrally Sponsored Schemes, many of which were integrated into the Direct Benefit Transfer System (DBTS). The purpose of this reform was to enhance transparency, ensure timely delivery of benefits, and reduce leakages in the distribution of public funds. By linking subsidies and welfare payments directly to beneficiaries, particularly those below the poverty line, and authenticating transactions through Aadhaar, DBT has strengthened monitoring, minimised pilferage, and significantly improved the efficiency of welfare schemes.

Importantly, the shift away from the plan–non-plan framework is not aimed at reducing public expenditure but at rationalising it. The broader goal is to ensure that spending is better targeted, more accountable, and aligned with developmental outcomes. By simplifying expenditure classification and improving delivery systems, these reforms contribute to more effective fiscal management and help reduce the fiscal deficit through better planning and efficient use of resources. Overall, the restructuring marks a positive step toward greater transparency, improved governance, and better alignment between public spending and public welfare.

2.2.7. Principles of Public Expenditure

❑ Maximise social welfare

Public expenditure, as a vital instrument of fiscal policy, must adhere to certain principles to ensure that limited financial resources are used in the most productive and socially beneficial manner. The underlying aim of these principles is to maximise social welfare, promote fiscal responsibility, and ensure that government spending translates into tangible and equitable developmental outcomes.

Historically, economists such as A.C. Pigou emphasised that public expenditure should continue up to the point where the marginal social benefit derived from each additional unit of expenditure equals the marginal social cost of raising that money through taxation. In simpler terms, government spending should be guided by the principle of achieving the maximum satisfaction of social needs with the least possible sacrifice of private welfare.

Over time, these ideas have evolved into a modern framework guided by the Three Es: Economy, Efficiency, and Effectiveness, which together form the foundation of contemporary public financial management.

2.2.7.1. The Three Es: Economy, Efficiency, and Effectiveness

Economy

- ❑ Minimising the cost of inputs

Economy refers to the principle of minimising the cost of inputs used in public spending without compromising the quality of services. It means obtaining goods and services of the right quality at the right time and at the lowest possible price. In essence, it discourages wastage, extravagance, and corruption. For example, a government department purchasing medical equipment through a transparent e-procurement system ensures economy by reducing middlemen costs and preventing overpricing.

Efficiency

- ❑ Relationship between inputs and outputs

Efficiency focuses on the relationship between inputs and outputs, specifically how well resources are converted into goods and services. Efficient expenditure implies that the government maximises output from a given level of input or minimises input for a given output. For example, when a local government uses digital platforms to deliver citizen services with fewer staff hours and better accessibility, it demonstrates efficiency in administration.

Effectiveness

- ❑ Assessing the impact and outcomes

Effectiveness evaluates whether the objectives of public spending are actually achieved. It assesses the impact and outcomes rather than just the process. Expenditure is considered effective when it meets the targeted goals of policy, such as poverty reduction, education improvement, or health enhancement. For example, expenditure on education becomes



effective when literacy rates rise and learning outcomes improve, not merely when funds are spent.

These principles ensure that public spending contributes to value for money, a benchmark for responsible governance and fiscal prudence.

2.2.8. Control and Monitoring of Public Expenditure

Effective control and monitoring of public expenditure are essential components of sound financial administration. They ensure that public resources are used efficiently, economically, and for the purposes approved by the legislature. The system of expenditure control in India operates through multiple institutional mechanisms, executive oversight, legislative scrutiny, and independent audit, supported by continuous monitoring during budget execution and financial reporting. These mechanisms together uphold transparency, accountability, and fiscal discipline across the public sector.

Institutional Mechanisms of Control: Executive, Legislature, and Audit

☐ First layer of control

The first layer of control rests with the Executive, which is responsible for implementing the budget in accordance with approved plans and regulations. Ministries and departments exercise internal financial control through financial advisers, drawing and disbursing officers, internal audits, and compliance with financial regulations such as the General Financial Rules (GFRs). These controls prevent misuse, ensure proper authorisation, and promote economy in expenditure.

☐ Legislative control through the budget

The Legislature exercises external control by granting authority to the Executive to spend public money. This begins with the passage of the Annual Financial Statement and continues through the scrutiny of expenditure during and after budget execution. Legislative control is fundamental in a parliamentary democracy, as it ensures that the government remains accountable to the representatives of the people.

☐ Role of Comptroller and Auditor General (CAG)

The third pillar is Audit, which provides an independent and professional assessment of how public money has been spent. Audit acts as a safeguard against financial irregularities and evaluates whether expenditure has achieved its intended purposes. In India, the Comptroller and Auditor General (CAG) plays a central role in monitoring public expenditure.

As a constitutional authority, the CAG audits the accounts of the Union and State governments, public sector undertakings, autonomous bodies, and other entities receiving government funds. The CAG's audit extends beyond simple financial verification to include compliance audit, propriety audit, and performance audit.

☐ Performance audit

Through performance audits, the CAG assesses whether government programmes are achieving intended outcomes in an efficient and effective manner. Audit reports submitted to Parliament and State Legislatures become important tools for improving governance, as they highlight deficiencies, inefficiencies, delays, and instances of wasteful expenditure. The CAG thus acts as a watchdog, reinforcing accountability and strengthening fiscal oversight.

☐ Scrutiny by the specialised Financial Committees

The findings of the CAG are further scrutinised by specialised Financial Committees of Parliament, which provide a detailed examination of expenditure trends and administrative performance. As part of this process, the Public Accounts Committee (PAC) examines the CAG's audit reports and seeks explanations from departments on irregularities, excess expenditure, or systemic weaknesses. The PAC ensures that government spending complies with legislative intent and financial rules. The scrutiny of the Estimates Committee focuses on the efficiency and economy of government expenditure. It studies budget estimates, suggests measures to reduce unnecessary spending, and recommends improvements in organisational and administrative practices. Similarly, the Committee on Public Undertakings (COPU) evaluates the functioning and financial performance of public sector enterprises. It reviews CAG reports related to PSUs, ensuring that public investments yield desirable outcomes. Parliament maintains continuous oversight through these committees, ensuring that public funds are used responsibly and effectively.

Monitoring throughout the cycle of expenditure is also an integral part of financial control. During budget execution, ministries track spending against allocations, prevent overruns, and ensure timely release of funds. Tools such as expenditure control registers, electronic public financial management systems (PFMS), and periodic financial reviews help maintain discipline.

Financial reporting ensures monitoring, providing real-time or periodic insights into expenditure patterns. Monthly,



quarterly, and annual reports enable the government to identify bottlenecks, adjust implementation strategies, and take corrective action where needed. These reports also support transparency, allowing for public scrutiny of government performance.

Summarised Overview

Public expenditure management is a crucial aspect of financial administration that focuses on how governments plan, allocate, and utilise financial resources. It ensures that public funds are used effectively to deliver services, maintain fiscal balance, and promote equitable development. The classification of public expenditure into categories such as revenue and capital, and developmental and non-developmental, helps policymakers understand its impact on economic growth and fiscal sustainability.

The guiding principles of public expenditure-economy, efficiency, and effectiveness-provide a framework for evaluating how well resources are used. Economy ensures minimisation of cost, efficiency focuses on optimal input-output ratios, and effectiveness emphasises achieving intended policy goals. Together, these principles promote accountability and transparency in public spending.

Controlling and monitoring mechanisms, such as legislative oversight, auditing, and performance evaluation, are vital for ensuring responsible expenditure. In India, institutions such as the CAG and Parliamentary Committees play an instrumental role in scrutinising public spending. With the advent of performance and outcome-based budgeting, governments increasingly focus on measurable results and fiscal discipline, marking a shift from input-oriented to performance-driven expenditure systems.

Self-Assessment Questions

1. Define public expenditure and explain its significance in modern public finance.
2. Distinguish between developmental and non-developmental expenditure with examples.
3. What is the difference between revenue and capital expenditure?
4. Explain the principle of 'economy' in public expenditure management.
5. How does efficiency differ from effectiveness in the context of government spending?
6. Describe the role of the Comptroller and Auditor General (CAG) in monitoring public expenditure.

7. What is performance-based budgeting, and how does it enhance expenditure efficiency?
8. Explain how parliamentary committees contribute to expenditure control.
9. Discuss the major challenges faced in ensuring transparency in public expenditure.
10. How have digital monitoring systems improved expenditure management in India?

Assignment

1. Critically examine the principles of economy, efficiency, and effectiveness in managing public expenditure with suitable illustrations.
2. Evaluate the institutional mechanisms available for the control and monitoring of public expenditure in India.
3. Discuss the classification of public expenditure and analyse its importance for fiscal management and policy formulation.
4. Analyse the significance of performance-based and outcome budgeting in ensuring effective public expenditure.
5. "Effective public expenditure management is the foundation of good governance." Discuss this statement in light of recent reforms in India.

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Space for Learner Engagement for Objective Questions

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SGOU



Ensuring accountability: Public Accounts Committee and the Office of CAG

Upon completion of this unit, learners will be able to:

- ## Background

Accountability is essential in a democracy. When governments collect taxes from citizens, people expect that money to be used responsibly and with the approval of their elected representatives. Because of this, systems need to be in place to monitor how public funds are spent and whether they achieve their intended goals.

In India, public finance accountability relies on the legislature, audit institutions, and parliamentary committees. The legislature approves how money is raised and spent, while bodies such as the Public Accounts Committee and the Comptroller and Auditor General check that funds are used properly. These steps help keep things transparent, prevent misuse, and build public trust in the government.

Keywords

Accountability, Legislature, Public Accounts Committee (PAC), Comptroller and Auditor General (CAG), Audit, Public Accounts, Transparency, Parliamentary Oversight

Discussion

Accountability in public finance means the government must explain how it collects and spends public money. This keeps the executive accountable to the legislature and, ultimately, to the people. In a democracy, regular checks on financial decisions help maintain this accountability.

The legislature plays a key role in this process. It approves taxes and spending, ensuring the executive does not exceed what is allowed. But accountability is not just about approving the budget. It also means checking if the money was used properly, efficiently, and for the right reasons.

The Public Accounts Committee (PAC) handles much of this work. The PAC reviews audit reports and assesses how Parliament's money was actually spent. It identifies cases where funds were misused, overspent, or not used as required by the rules. By asking officials questions and demanding explanations, the PAC keeps the executive accountable for its financial actions.

The Comptroller and Auditor General (CAG) helps by conducting an independent, detailed audit of government accounts. The CAG checks if financial records are kept correctly and if spending follows legal and procedural rules. The CAG's reports point out problems, inefficiencies, and rule-breaking, which the PAC then reviews.

In this way, accountability in public spending depends on both audits and legislative review. Audits provide the facts, while parliamentary committees interpret them and hold the executive responsible. This system helps prevent misuse of funds, improves financial discipline, and makes government more transparent.

2.3.1 Concept of Accountability in Public Finance

Accountability in public finance means that public officials must report on, explain, and take responsibility for how they use



public money. Those given financial authority need to justify their decisions and actions to the right bodies. This goes beyond answering questions; it is about being responsible for results and ensuring public funds serve the public good.

❑ Accountability as both answerability and responsibility

Experts in public administration describe accountability as both answerability and responsibility. M. J. Dubnick says accountability means informing others, justifying actions, and accepting the consequences. Paul Appleby also saw accountability as key to democratic government, where officials must follow the law and answer to political leaders. In public finance, this means financial choices should be clear, legal, and open to review.

Accountability also follows a clear process. It includes keeping accurate accounts, presenting financial information in an organised way, and having independent audits. This process ensures that financial transactions are recorded and checked to ensure they comply with the law and meet their goals. In this way, accountability links financial management to institutional oversight.

In practice, accountability in public finance works through a chain of responsibility. The executive branch manages public funds, the legislature approves and reviews their use, and independent bodies ensure that everything is correct. This system ensures that financial power is limited and that public resources are managed carefully and responsibly.

2.3.1.2. Significance of Accountability in Public Finance

❑ Responsible governance and the proper use of public resources

Accountability in public finance is important because it helps ensure responsible governance and the proper use of public resources. It protects against misuse, inefficiency, and corruption by requiring the executive to explain its financial decisions. Tools like audits and legislative reviews check if public money is spent as the legislature intended.

Accountability also encourages transparency in financial management by requiring regular reports and clear information about financial activities. This openness lets both lawmakers and the public judge how well the government is performing and spot any problems. It also helps the legislature maintain control over public finances, ensuring the executive does not exceed its authority in taxation and spending.

Accountability also helps make administration more efficient. When officials know their actions will be reviewed, they tend to be more careful and use resources wisely. This results in better financial management and improved public services. More broadly, accountability supports democracy by ensuring the government answers to the people and follows the law and the public interest.

2.3.3 Institutional Mechanisms for Ensuring Accountability

In a democracy, public financial accountability is managed by several institutions working together, not by a single authority. These agencies ensure public funds are used as lawmakers intend and in accordance with the rules. The executive manages finances but is always monitored by independent and parliamentary bodies that check how money is spent.

□ Accountability relies on both audits and legislative oversight.

In India, accountability relies on both audits and legislative oversight. Independent auditors review financial records and identify any problems, while parliamentary committees review these reports and question the executive. This setup makes financial accountability an ongoing process, not just a formality.

Important institutions like the Comptroller and Auditor General (CAG), the Public Accounts Committee (PAC), and the Committee on Public Undertakings (COPU) are central to this system. The CAG independently reviews government accounts, and the PAC and COPU study these reports closely and ask officials for explanations. Working together, these groups make public spending more transparent and accountable to democracy.

2.3.3 Role of the Comptroller and Auditor General (CAG)

The Comptroller and Auditor General (CAG) of India occupies a vital constitutional position as the guardian of public finances. According to the Constitution, the CAG is entrusted with the responsibility of auditing all receipts and expenditures of the Government of India and the state governments, including bodies and authorities substantially financed by the government. Although the CAG is appointed by the President, the office functions independently of the executive, ensuring objectivity and impartiality in its operations.

□ Guardian of public finances



❑ Sources of Power

The powers of the CAG are derived from the Constitution as well as from statutory provisions such as the Comptroller and Auditor General's (Duties, Powers, and Conditions of Service) Act, 1971. This Act empowers the CAG to scrutinise government accounts, authorise withdrawals from the Consolidated Fund, and ensure that money is spent only for purposes sanctioned by a competent authority. Historically, the CAG combined both accounting and auditing roles; however, over time, its functions have evolved mainly towards auditing, divesting many of the earlier comptroller functions.

Key Constitutional Provisions on the CAG (Articles 148–151)

Article 148: Appointment & Independence

- CAG appointed by the President; removal like a Supreme Court Judge.
- Salary, service conditions protected from disadvantageous changes.
- Administrative expenses charged on the Consolidated Fund → ensures autonomy.

Article 149: Duties & Powers

- Parliament defines CAG's functions by law.
- Till then, CAG retains pre-Constitution powers.

Article 150: Form of Accounts

- Union and State accounts kept in a form prescribed by the President after consulting CAG.

Article 151: Audit Reports

- CAG submits reports to the President/Governor.
- Reports must be laid before Parliament/State Legislature.

2.3.2.2. Audit Functions and Reporting Mechanisms

The audit functions of the CAG are comprehensive, covering audits of expenditure, rules and orders, and propriety. The audit of expenditure verifies whether government spending has the necessary legal sanction, complies with relevant constitutional

❑ Audit of expenditure

and statutory provisions, and aligns with financial rules. The CAG ensures that the expenditure is properly authorised, economically justified, and faithfully executed for the purpose it was intended.

☐ Propriety audit

An audit against rules and orders ensures conformity to the provisions of the Constitution, laws, and regulations framed thereunder. Additionally, propriety audits evaluate whether expenditures serve the public interest and whether officials have exercised due prudence, economy, and integrity in handling public funds.

☐ Value for Money (VFM) audit

The CAG also undertakes Value for Money (VFM) audits to assess efficiency, economy, and effectiveness in the use of public resources. The reports prepared by the CAG are submitted to the President or the Governors, who in turn lay them before Parliament or the State Legislatures. This reporting mechanism ensures transparency and accountability, enabling legislative oversight over financial administration.

☐ Link between the executive and the legislature

2.3.2.3. Relationship with the Legislature

The CAG serves as an indispensable link between the executive and the legislature in matters of financial accountability. While audits are conducted on behalf of the executive, the reports are ultimately submitted to the legislature through the Public Accounts Committee (PAC). This arrangement ensures that the expenditure of public funds remains subject to legislative scrutiny.

☐ Democratic control, transparency, and financial propriety

In addition, the findings of the CAG assist the legislature in identifying cases of financial irregularities, inefficiency, and wastefulness in public spending. Through this process, the legislature can hold the executive accountable for the management of public finances. Thus, the CAG reinforces the principles of democratic control, transparency, and financial propriety in governance.

In summary, the CAG stands as the cornerstone of India's financial control system. By combining constitutional authority, technical expertise, and institutional independence, the CAG upholds the accountability of the government to the people and ensures that every rupee from the public exchequer is spent legally, wisely, and in the public interest.



❑ Directly examines government expenditure

2.3.3.1 Public Accounts Committee (PAC)

The Public Accounts Committee (PAC) is one of the most significant parliamentary committees that directly examines government expenditure and ensures that public money is used efficiently and lawfully. Established in 1950, soon after the Constitution came into force, the PAC derives its mandate from the rules framed under Article 118(1) of the Constitution.

Composition

Originally consisting of 15 members from the Lok Sabha, the PAC was reconstituted in 1955 to include 22 members: 15 from the Lok Sabha and 7 from the Rajya Sabha. Members are elected annually by Parliament through proportional representation by means of a single transferable vote, ensuring representation across parties. The Speaker of the Lok Sabha appoints the Chairman of the committee from the Opposition, as per convention. This enhances the spirit of bipartisan oversight. The quorum for a valid meeting is four members, and the Chairperson has a casting vote in the event of a tie.

Functions

The PAC primarily performs a post-audit examination of government accounts. Its major functions include:

- Scrutinising the reports of the Comptroller and Auditor General (CAG) of India.
- Examining the Appropriation Accounts and Finance Accounts of the Government to ensure that funds have been spent only for purposes sanctioned by Parliament.
- Verifying that re-appropriations of funds, where made, comply with legal provisions.
- Examining trading, manufacturing, and profit and loss accounts of government departments and enterprises, as reported by the CAG.

The PAC does not question the policy underlying expenditure; rather, it focuses on legality, efficiency, and propriety.

Procedure and Importance

The Committee studies CAG reports ministry-wise, summoning departmental officers to clarify audit observations. Based on these deliberations, it prepares its own report and

submits recommendations to Parliament, with an Action Taken Report (ATR) later presented by the Government through the Ministry of Finance.

❑ Financial watchdog of Parliament

The PAC thus acts as the financial watchdog of Parliament. By detecting irregularities, exposing wasteful expenditure, and recommending reforms, it ensures executive accountability. In essence, it serves as the "searchlight" of Parliament, illuminating areas of financial mismanagement and upholding the integrity of public finance in a democracy.

2.3.3.2 Estimates Committee

❑ Complementary to the work of the PAC

The Estimates Committee is another major financial committee of Parliament that complements the work of the PAC by focusing on the future needs, efficiency, and economy of government operations. First constituted in 1950, it plays a proactive role by examining estimates included in the annual budget. With a membership of 30 members, all from the Lok Sabha and elected annually through proportional representation, the Committee does not include any Rajya Sabha members. The Chairperson is traditionally from the ruling party, reflecting its forward-looking and advisory role.

Functions

The Estimates Committee undertakes a wide range of responsibilities:

- Examining budget estimates to suggest economies and improvements in organisational efficiency.
- Evaluating whether funds are used within the limits of policy sanctioned by Parliament.
- Reviewing the effectiveness of administrative machinery and suggesting reforms.
- Studying whether proposed expenditures are justified and aligned with intended outcomes.
- Identifying potential areas for reducing wasteful expenditure and enhancing returns on public spending.

Unlike the PAC, which performs post-audit scrutiny, the Estimates Committee works in an ex-ante manner. In other words, it recommends structural and procedural changes before expenditure occurs. The Committee plays a critical role in promoting economy and effectiveness in government functioning by advocating improvements in administrative efficiency, rational allocation of resources, and better performance



management. Its reports have influenced administrative reforms and the modernisation of public institutions over the decades.

2.3.3.3 Committee on Public Undertakings (COPU)

❑ Oversight of public sector undertakings (PSUs)

Despite the establishment of the PAC and the Estimates Committee, Parliament's oversight of public sector undertakings (PSUs) was long considered inadequate. With the growing number of government-owned enterprises after Independence, it became evident that specialised scrutiny was needed. This led to the formation of the Committee on Public Undertakings (COPU) in 1964, following recommendations by the Ashok Mehta Committee (1956) and later endorsement by the Krishna Menon Committee.

Composition and Tenure

The COPU consists of 15 members, 10 from the Lok Sabha and 5 from the Rajya Sabha, elected by Parliament through proportional representation using the single transferable vote system. Members hold office for five years, with one-fifth retiring annually by rotation, ensuring continuity and experience within the Committee.

Jurisdiction

The Committee's jurisdiction extends over a wide range of central public undertakings, including major corporations like the Damodar Valley Corporation (DVC), Life Insurance Corporation (LIC), Oil and Natural Gas Commission (ONGC), Bharat Heavy Electricals Limited (BHEL), Steel Authority of India Limited (SAIL), and Hindustan Aeronautics Limited (HAL), among others. However, its purview excludes undertakings where the government holds only minority shares or which are governed by specific statutory frameworks.

Functions

The COPU performs several key functions:

- Examines the reports and accounts of public undertakings.
- Reviews the CAG reports relating to PSUs and may refer matters for further examination.
- Assesses the efficiency, economy, and autonomy in the operations of public enterprises.
- Considers any matter relating to public undertakings that the Speaker specifically refers to it, including issues

overlapping with the PAC or the Estimates Committee.

Limitations and Evaluation

❑ Limited size and jurisdiction

The COPU's authority is, however, circumscribed. It cannot question the policy decisions of the Government or interfere in the day-to-day administration of undertakings. Its limited size and jurisdiction restrict the scope of its supervision. Nonetheless, by serving as a fact-finding body, it provides Parliament with valuable insights for debate and reform.

Although the performance of many public enterprises remains a subject of concern due to inefficiency, overstaffing, and wasteful expenditure, the COPU's reports have contributed substantially to improving accountability and transparency. It plays a vital role in bridging the gap between Parliament and the Public Sector, ensuring that public undertakings function in alignment with national objectives and sound financial management.

Feature	Public Accounts Committee (PAC)	Estimates Committee	Committee on Public Undertakings (COPU)
Year of Establishment	1950	1950	1964
Primary Purpose	Post-audit scrutiny of expenditure	Examining budget estimates and suggesting improvements	Oversight of Public Sector Undertakings (PSUs)
Nature of Control	Ex-post (after expenditure is incurred)	Ex-ante (before expenditure takes place)	Concurrent and ex-post (ongoing review of PSUs)
Total Members	22 (15 Lok Sabha + 7 Rajya Sabha)	30 (All from Lok Sabha)	15 (10 Lok Sabha + 5 Rajya Sabha)
Mode of Election	Proportional representation (single transferable vote)	Proportional representation (STV)	Proportional representation (STV)
Chairperson	From the Opposition (by convention)	From the ruling party (traditionally)	From either House; usually ruling party
Key Functions	Examines CAG reports	Examining budget estimates	Examines CAG reports on public undertakings

Table no: 2.3.2: Comparison of PAC, Estimates Committee, and COPU



2.3.4 Challenges in Financial Accountability

- ❑ Structural, administrative, and political challenges

Financial accountability forms the backbone of a robust public financial management system, ensuring that public resources are used lawfully, efficiently, and for their intended purposes. In a democratic system, it strengthens trust between the government and citizens, reinforces legislative control, and promotes transparency in fiscal operations. Despite its central role in governance, financial accountability in India faces persistent structural, administrative, and political challenges. These challenges undermine the effectiveness of oversight mechanisms and weaken the ability of institutions to monitor, evaluate, and correct financial irregularities. Understanding these barriers is, therefore, essential for designing reforms that can enhance transparency, efficiency, and public trust in government expenditure.

Lack of Transparency

- ❑ Limited disclosure of financial data

One of the major issues is the lack of transparency in public financial operations. Many government departments still function with limited disclosure of financial data, making it difficult for citizens, media, and oversight bodies to access timely and reliable information. This opacity often leads to the misuse of funds, corruption, and inefficiency in public expenditure. The absence of easily accessible audit reports or digital financial dashboards further complicates public scrutiny.

Delay in Financial Reporting and Auditing

Government accounts and audit reports are often prepared and released long after the end of the financial year. Such delays diminish the relevance of the information for decision-making and weaken legislative control over finances. When audit observations reach Parliament or State Legislatures late, remedial action also gets postponed, allowing systemic lapses to persist. The procedural complexity of financial management and the limited capacity of accounting personnel at various administrative levels also contribute to these delays.

Political interference poses an additional hurdle to maintaining financial discipline

Political leaders often influence budget allocations, project approvals, and fund releases for electoral or partisan gains. This interference undermines the objectivity of administrative

☐ Populist spending

processes and distorts development priorities. Instances of populist spending, misallocation of resources, and preferential treatment to certain sectors or regions often arise due to such political considerations. As a result, public funds are not always directed towards the most essential or productive areas, weakening the overall accountability framework.

In short, these obstacles limit the effectiveness of audits, hinder the enforcement of fiscal discipline, and weaken public confidence in financial governance. Addressing them requires a coordinated approach, greater transparency through digital platforms, timely financial reporting, professional strengthening of accounting systems, and insulating financial decisions from political influence. Only through such comprehensive reforms can the public financial management system truly uphold accountability, safeguard public resources, and contribute to sustainable and equitable development.

2.3.5 Reforms in Financial Accountability

☐ Results-oriented, technology-enabled reforms

Financial accountability in modern public administration has undergone significant transformation, driven by the growing need for transparency, efficiency, and citizen trust in government operations. As public expenditure has expanded in scale and complexity, traditional oversight mechanisms have proved inadequate. This has led to the adoption of a range of reforms aimed at strengthening institutional capacity, improving fiscal transparency, and enabling real-time monitoring of public funds. These reforms reflect the broader shift from procedural, control-oriented financial management to a results-oriented, technology-enabled, and participatory framework that aligns with contemporary governance standards.

E-Governance and Digital Financial Management Systems

☐ Public Financial Management System (PFMS)

In response to long-standing challenges such as delays, opacity, and inefficient manual processes, governments have increasingly embraced e-Governance tools and digital financial management systems. A prominent initiative is the Public Financial Management System (PFMS), which enables real-time tracking of fund disbursements, reduces leakages, and enhances accountability across all stages of expenditure. Digital dashboards, online audit trails, electronic payment systems, and integrated financial databases have improved the accuracy, speed, and transparency of public financial operations. Moreover, the adoption of performance-based and outcome budgeting marks



a shift from conventional expenditure tracking to a system that evaluates government programmes based on outputs and outcomes. This approach strengthens the accountability of ministries and departments by ensuring that financial allocations are linked to measurable results and service delivery performance. Additionally, independent oversight bodies such as the Comptroller and Auditor General (CAG) have benefited from the integration of modern audit tools, data analytics, and performance auditing techniques, enabling deeper scrutiny of government spending and programme effectiveness.

Social Audits and Citizen Participation

❑ Bottom-up accountability mechanisms

Citizen involvement has emerged as a vital complement to institutional reforms. Social audits, especially in programmes like MGNREGA and the Public Distribution System (PDS), allow communities to directly examine records, verify expenditures, and assess service delivery at the grassroots level. This bottom-up accountability strengthens democratic participation and helps identify irregularities that might escape formal audits. The Right to Information (RTI) Act, Open Government Data (OGD) platforms, and public disclosure norms have institutionalised transparency by enabling citizens, researchers, and civil society groups to access financial records and programme data. These practices reduce information asymmetry, discourage corruption, and create a more informed and vigilant citizenry that actively participates in monitoring public finance.

In short, these reforms represent a significant evolution in the field of financial accountability. The integration of technology, enhanced audit capacity, performance-linked budgeting, and community participation has made public financial management more transparent, responsive, and results-oriented. While challenges such as bridging digital divides, ensuring data reliability, and strengthening institutional capacities still remain, these reforms mark a decisive shift towards a more open and collaborative model of financial governance.

Summarised Overview

Accountability in public finance ensures that the government remains answerable for how public money is collected and spent. In a democratic system, this accountability is maintained through a combination of legislative oversight and independent auditing. The legislature approves financial proposals and examines their implementation, ensuring that public funds are used only for authorised purposes.

Institutions such as the Comptroller and Auditor General (CAG), the Public Accounts Committee (PAC), the Estimates Committee, and the Committee on Public Undertakings (COPU) play a crucial role in this process. The CAG conducts independent audits and highlights irregularities, while parliamentary committees examine these findings and hold the executive accountable. Together, they ensure transparency, efficiency, and adherence to financial rules.

At the same time, challenges such as lack of transparency, delays in reporting, and political interference affect the effectiveness of accountability mechanisms. Recent reforms, including digital financial systems and social audits, aim to strengthen transparency and improve the monitoring of public expenditure. Overall, accountability remains essential for maintaining fiscal discipline and public trust in governance.

Self-Assessment Questions

1. What is meant by accountability in public finance?
2. Explain the role of the legislature in ensuring accountability.
3. What are the major functions of the Comptroller and Auditor General (CAG)?
4. How does the Public Accounts Committee (PAC) ensure financial accountability?
5. Distinguish between the roles of PAC and Estimates Committee.
6. What is the significance of the Committee on Public Undertakings (COPU)?
7. Explain the relationship between the CAG and the legislature.
8. Identify the major challenges in ensuring financial accountability.
9. How do audits contribute to transparency in public finance?
10. What is the role of digital systems like PFMS in strengthening accountability?



Assignment

1. Examine the concept of accountability in public finance and its importance in democratic governance.
2. Analyse the role of the Comptroller and Auditor General (CAG) in ensuring accountability of public expenditure.
3. Discuss the functions and significance of the Public Accounts Committee (PAC) in parliamentary control over finance.
4. Evaluate the role of parliamentary committees, including PAC, Estimates Committee, and COPU, in ensuring financial accountability.
5. Discuss the challenges in financial accountability in India and examine recent reforms aimed at improving transparency and efficiency.

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Suggested Reading

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Space for Learner Engagement for Objective Questions

Learners are encouraged to develop objective questions based on the content in the paragraph as a sign of their comprehension of the content. The Learners may reflect on the recap bullets and relate their understanding with the narrative in order to frame objective questions from the given text. The University expects that 1 - 2 questions are developed for each paragraph. The space given below can be used for listing the questions.

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MODEL QUESTION PAPER - SET 2

Course Code: M23PS02SC

Course Title: Financial Administration

Time: 3 Hours

Max Marks: 70

SECTION A

Answer any ten questions in a word or a sentence. Each question carries one mark

(10 × 1 = 10 Marks)

1. Define Financial Administration.
2. What is a Budget?
3. Expand CAG.
4. What is Public Revenue?
5. Define Public Expenditure.
6. What is Fiscal Policy?
7. What is a Tax?
8. Define Audit.
9. What is Performance Budgeting?
10. What is Zero-Based Budgeting?
11. Define Public Debt.
12. What is Deficit Financing?
13. What is Outcome Budgeting?
14. Define Social Audit.
15. What is Financial Accountability?

SECTION B

Answer any five questions in two or three sentences. Each question carries two marks.

(5×2 =10 Marks)

16. Explain the meaning of financial administration.
17. State any two objectives of budgeting.



- ## SECTION C

(5×4 = 20 Marks)

- ## SECTION D

(3×10 =30 Marks)

- 108



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Time: 3 Hours

Max Marks: 70

SECTION A

Answer any ten questions in a word or a sentence. Each question carries one mark

(10 × 1 = 10 Marks)

1. What is Financial Management?
2. Define Public Finance.
3. What is a Supplementary Budget?
4. Expand PAC.
5. What is Revenue?
6. Define Capital Budget.
7. What is Tax Evasion?
8. Define Financial Control.
9. What is Gender Budgeting?
10. Define Fiscal Responsibility.
11. What is Public Borrowing?
12. What is Internal Debt?
13. What is External Debt?
14. Define Transparency.
15. What is Outcome Audit?

SECTION B

Answer any five questions in two or three sentences. Each question carries two marks.

(5×2 =10 Marks)

16. What are the elements of financial administration?
17. Explain the significance of budgeting.
18. State the functions of the Public Accounts Committee.



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വിദ്യാതൽ സ്വതന്ത്രരാകണം
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ഗുരുപ്രകാശമേ നയിക്കണം

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സ്നേഹദീപ്തിയായ് വിളങ്ങണം
നീതിവൈജയന്തി പാറണം

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ജാതിഭേദമാകെ മാറണം
ബോധരശ്മിയിൽ തിളങ്ങുവാൻ
ജ്ഞാനകേന്ദ്രമേ ജ്വലിക്കണം

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