

# **Public Account – A Continuing Aberration in Our Financial System**

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*Abstract: Public Account funds being managed by the Government is a perpetual source of distortion in our public finances. It is time to separate all Public Account funds from the cash balances of the Government and entrust their management to professional trusts free from Government control. Apart from making these funds self-sustaining, this will also enforce much greater discipline in the management of fiscal deficits and public debt.<sup>1</sup>*

## **Structure of Government Finance**

Part XII of Indian Constitution deals with government finance which is organized under three funds. Under article 266 (1), all revenues received by the Government of India or any state, all loans raised by the issue of treasury bills, loans or ways and means advances and all moneys received by the Government in repayment of loans shall form one consolidated fund, to be entitled the Consolidated Fund of India or of the State, as the case may be. Article 266 (2) says that all other public moneys received by or on behalf of the Government of India or of a State, shall be credited to the Public Account of India or of the State. Finally, a Contingency Fund will be created under article 267 with a fixed corpus to enable the Government to make unforeseen expenditure without prior legislative approval (e.g. expenditure on relief after a natural calamity), later to be recouped from the Consolidated Fund under the usual legislative approval procedures. Government accounts record all transactions pertaining to the above three funds.

Further, article 266 (3) states that no moneys out of any Consolidated Fund shall be appropriated except in accordance with law - for the purposes and in the manner provided in the Constitution. The manner of such appropriation falls under the respective “Procedure in Financial Matters” under Chapter II for the Parliament (articles 112 to 117) and Chapter III for the State Legislatures (articles 202 to 206) of the Constitution. No such legislative approval, however, has been prescribed for withdrawing any money from the Public Account, which does not involve revenues or debt of the Governments but other public moneys that do not belong to the Government as such. Thus there is no legislative control over the use of funds from the Public Account, and it is this lack of legislative control that makes the article 266(2) somewhat intriguing, and this is what also makes it vulnerable to misuse and subject to many aberrations in our financial system. Only three countries in the Indian subcontinent – India, Pakistan and Bangladesh - that share the common burden of partition, population and poverty and still nurture a dated Government financial system bequeathed by the British two thirds of a century ago, have a public account - no other country in the world has such distortion in their financial system.

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It is interesting to trace how this article came to be included in the Constitution. Many articles in our Constitution can be traced to the earlier Government of India acts, but article 266(2) did not have any corresponding presence in those Acts - it came into existence only after independence when the Constitution of the new republic was adopted. Proposing this article on the creation of Public Account, the Constituent Assembly had noted:

*“in drawing the definition of the Consolidated Fund we lumped along with it certain other moneys which were received by the state, but which were not the proceeds of taxes or loans, etc., with the result that public money received by the state otherwise than as part of the revenues or loans also became subject to an Appropriation Act...Obviously the withdrawal of money which should strictly not form part of the Consolidated Fund of the State cannot be made subject to any Appropriation Act. They will be left open to be drawn upon in such manner, for such purposes and at such times subject to such conditions as may be laid down by Parliament in that behalf specifically. It is, therefore, to enlarge the definition expressly of the Consolidated Fund and to separate the Consolidated Fund from other funds which go necessarily into the public account that these changes are made. There is no other purpose in these changes.”<sup>i</sup>*

Thus the Public Account came into existence more as an administrative convenience rather than an economic necessity: *“The Finance Ministry drew attention to the fact that our provision in regard to the Appropriation Act was also made applicable to other moneys which generally went into the public account and that was likely to create trouble. It is in order to remove these difficulties that these provisions are now introduced in the original article.”<sup>ii</sup>*

It is to be noted that no procedure as promised in the debate above has since been laid down by the Parliament, in the absence of which the Governments have complete liberty to use these funds the way they like - a liberty that overrides all accountability and legislative control. But before proceeding further, let us understand the nature of transactions that go into the Public Account.

### **Structure of Public Account**

There are five major heads of accounts under the Public Account: (i) Small Savings, Provident Fund and Other Accounts (ii) Reserve Funds (iii) Deposits and Advances (iv) Suspense and Miscellaneous and (v) Remittances. A full length discussion on these is beyond the scope of this paper. Briefly, these accounts comprise funds that do not belong to the Government, but which the government holds in trust and manages on behalf of their owners who can be ordinary people or government contractors or anyone, and sometimes even the Government itself when it holds taxpayers' money outside of Consolidated Fund. Once some money gets parked in the public accounts, the legislative process of voting the appropriations and exercising controls over the use of those appropriations through examination of audit reports by the Public Accounts Committee cease to operate in respect of these funds. Some of these funds are interest bearing on whose

balances the Government has to pay interest from the Consolidated Fund using taxpayers' money - others may not carry any interest liability.

The first three of these accounts deal with receipts and payments in respect of which the Government is liable to repay the moneys received or has a claim to recover the amounts paid. In respect of these transactions, the Government acts as a banker, receiving amounts which it later repays and paying out advances which it subsequently recovers. Provident Funds of Government Employees, Deposits of Local Funds, Reserve Funds Deposits made by outside agencies, Departmental Advances, etc. fall under this category. Balances in these accounts constitute a part of the overall financial liabilities of the Government, a proposition whose logic is not beyond doubt.<sup>iii</sup> The other two accounts – Suspense and Remittances - are used only for adjustment purposes; all initial debits or credits to these accounts are made pending final adjustments and cleared eventually by mutual adjustments once their final destinations are traced.<sup>iv</sup>

The most important of these accounts is of course the “Small Savings, Provident Funds and Other Accounts” that includes a number of interest bearing obligations in respect of provident fund contributions of all Government and non-Government employees and some other contributions. Government has to pay interest on moneys deposited in these funds at the prescribed rates, and in return can use this money for investment in specified Government securities; such investments can eventually be channeled for development purposes for which the funds provide a ready source of capital at the disposal of the Government. Because of this reason, the logic of including these balances in the Government's total financial liabilities along with outstanding public debt is perhaps understandable, but the logic behind including the balances of other heads of Public Account in the Government's total liability is often baffling. For example, the Reserve Funds are created by debit to the Consolidated Fund to create reserves which are assets, e.g. for the renewal/ replacement of assets of Governments / parastatals (Depreciation Reserve Funds of Government Commercial Concerns), for amortization of loans raised by the Government (Sinking Funds) and for other specific and sometimes esoteric purposes, such as Hindu Religious and Charitable Endowment Fund, Famine Relief Fund, various Development and Welfare Funds, State Roads and Bridges Fund, Calamity Relief Fund, State Disaster Response Funds etc.<sup>v</sup> But these are shown as Government's funds liabilities to the respective funds. Some of these are interest bearing and some are not, and all these funds are managed by the Government usually through the Secretaries / Principal Secretaries of the concerned Departments/ Ministries. The Government creates these funds out of taxpayers' money and then pays interest to these funds again by using taxpayers' money; it also controls the use of these funds through its administrators who are its own bureaucrats, but without any accountability to the Legislature, as these funds are maintained outside the Consolidated Fund. Many of these funds also remain inoperative for a number of years; in West Bengal, for example, 23 of its 31 Reserve Funds have remained inoperative for more than 5 years as on 31<sup>st</sup> March 2012.

The Deposit head under 'Deposits and Advances' includes sums deposited with Government in the daily course of business by members of the public, e.g. deposits made in connection with revenue administration, deposits made in civil and criminal courts, security deposits taken from government servants/ contractors when required, public works and earnest money deposits, deposits made by electoral candidates, deposits of local funds of municipalities and panchayats, electricity boards, housing boards, universities etc. Like the reserve funds, some of these again carry interest liability while others do not; but all these are included in the Government's total financial liabilities. Civil Advances relate to interest free temporary advances including advances of a permanent nature held by Government officers to enable them to incur contingent expenditure in the day to day administration like the Permanent Cash Imprest.

It is to be understood that all these accounts stand merged in the cash balance of the Government - none of these accounts have separate funds maintained in their names anywhere; they lose their individual identities by being part of the cash balance which represents the combined balances in the Consolidated Fund, Contingency Fund and Public Account. Public Account balances, being part of the cash balances of the Government, thus inflate them and also make the cash management of the Government fraught with risks.

The way these accounts are maintained, especially the interest bearing ones, again defies all logic. For example, there is one fund created in 1999 under the Small Savings called the National Small Savings Fund (NSSF) to which all public deposits under the Central Government's small savings schemes are credited. States have to borrow 80% of the accumulated balances under this fund mandatorily (and hence pay interest to the Centre), with the option to go up to 100%. This borrowing, strangely, is based on availability rather than requirement. As of 31st March 2009, the States owed Rs 4.32 lakh crore to this fund, four of them- UP, Gujrat, West Bengal and Maharashtra- accounting for 52% of the outstanding NSSF debt. Securities issued to NSSF used to be a major source of financing the GFD of the States till 2006-07 when the interest rates became more favourable to the market loans and the NSSF share had dwindled; excess NSSF flows before that were also responsible for the subsequent build up surplus cash with the State governments.<sup>vi</sup>

Many of these funds are again created by transferring taxpayers' money from the Consolidated Fund, and kept at the disposal of the Government. The license to do so freely often allows the Government to devise ingenious ways to defeat the normal accountability controls. One such control is that any unspent fund lapses at the end of the financial year under any budget grant for which the legislature had voted; such unspent funds, or 'savings', cannot be carried over to the next year and must be surrendered back at the close of the financial year, to be included in the fresh budgetary appropriations next year if needed. One mechanism the Governments often use to defeat such statutory control is to withdraw these savings from the Consolidated Fund and park them in the so-called Personal Ledger Accounts maintained under the Public Account so

that the funds can remain there indefinitely at the disposal of the Government without any legislative scrutiny - an aberrations made possible by the nature of Public Account.

The interest liability of the Government of India during 2011-12 on its public account balances was Rs 40,912 crore, or 14% of its total interest liability. As regards the States, even a deeply indebted state like West Bengal had to dish out Rs 1100 crore, or 7% of its total interest liability in 2011-12 on Public Account. This interest constituted as much as 20% of the total interest liability for Assam, 22% for Odisha and 27% of another highly indebted state, Himachal Pradesh in that year. In all other countries, similar funds are managed by professional bodies that determine their investment in appropriate assets so as to earn commercial interests to make these funds self-sustainable, without forcing the taxpayers to foot their interest bills.

### **Paradox of Surplus Cash and Heavy Borrowing**

The Gross Fiscal Deficit (GFD) of the Government- the total resource gap in the economy- can be computed as the sum total of its revenue deficit, capital outlay and net lending; it is financed partly by raising public debt through borrowing under the Consolidated Fund, partly by using the Public Account resources and the rest by drawing down the cash balances. The entire resources under the Public Account which is a part of the cash balance is available to the Government and often the Government is forced to resort to over-borrowing – such over-borrowing leads to building up of idle cash balances that earn very little from their investments in low-earning Treasury Bills, while the Government continues to pay much higher rate of interest on the borrowed funds. Most state governments resort to over-borrowing despite having substantial surplus cash balances that could otherwise be economically utilized to finance their fiscal deficits.

RBI is the banker to any Government and besides the State's deposits with RBI, the cash balance of the State also comprises the investments held in the Cash Balance Investments Account, cash and permanent advances for contingent expenditure with Departmental officers plus the investments of Earmarked Funds under the Reserve Funds. Under agreements with the RBI, every State Government has to maintain a minimum cash balance with it (*about Rs 2-3 crore*). If the actual cash balance falls below the agreed minimum on any day, the deficiency is made good by taking normal and special ways and means advances/overdrafts and if there is any surplus above the specified minimum, it is automatically invested in 14-day Intermediate Treasury Bills (ITBs) of the Government of India that carried 5% interest in 2011-12. This rate is significantly lower than that paid on the market borrowings by the States and hence constitutes a negative carry for them. RBI also conducts weekly / fortnightly auctions of treasury bills for maturity periods of 91 days, 182 days or 364 days (Auction Treasury Bills or ATBs) that carry slightly higher rates of interest. Since states can invest the surplus cash only in ITBs or ATBs, they earn lower returns on these investments compared to the interest they pay on their market borrowings; ideally, they should then use their surplus cash balances to meet their GFD financing requirement and thereby curtail their market borrowings.

The surplus cash balance is the difference between the total financing raised by the states (net of all repayments and disbursements) through borrowing under the Consolidated Fund plus the surplus in the Public Account less their GFD requirements. While the borrowing under Consolidated Fund can be adjusted according to the needs, the surplus in Public Account is totally beyond Government's control, and this is what leads to over-borrowing.

From Table 1, it is seen that the States' combined fiscal deficits during 2010-11 were Rs 161,219 crore, which were financed by fresh borrowings, net of repayments of existing debt obligations, and also by the surpluses in their public accounts, resulting in over-borrowing to the extent of Rs 3218 crore, which generated surplus cash by that amount during that year. <sup>vii</sup> Such cash surpluses generated year after year had accumulated to a huge combined surplus cash balance of Rs 141,551 crore for all states by the end of 2010-11, held in Cash Balance Investment Account and Earmarked Funds, as well as in deposits with the RBI. The total interest paid by States on their outstanding debt during the year was Rs 127,653 crore, which included interest of Rs 19546 crore on their Public Account balances. This was much higher than Rs 4405 crore they had earned during the year from investment of their cash surpluses in treasury bills, hence there was a negative carry of Rs 15141 crore on this account.

Table 1: Surplus Cash and Debt Liabilities of All States, FY 2010-11 (Rs Crore)<sup>viii</sup>

<b>Gross Fiscal Deficit</b>	<b>161219</b>
<b>Constituted of:</b>	
1. Revenue Deficit	-13256
2. Capital Outlay	154861
3. Net Lending	19614
<b>Financed By:</b>	
1. Net receipts in Public Account	34807
2. Net borrowings from Consolidated Fund	129630
3. Drawing down of Cash Balance	-3218
<b>Borrowings</b>	
Market Loans of State Govt.	207372
Loans and Advances from the Central Govt.	14174
<b>Total Borrowing under Consolidated Funds</b>	<b>221546</b>
<b>Total Repayment</b>	<b>91916</b>
Surplus cash held in Cash Balance Investment Account and in Earmarked Funds under Reserve Funds in Public Account plus Deposits with RBI	141551
Interest earned on cash surplus	4405
<b>Interest paid on existing debt, of which</b>	<b>127653</b>
1. Interest paid on market loans	95394
2. Interest paid on Central loans	12713
3. Interest paid on Public Account balances	19546
<b>Total balances held under PF, Small Savings etc., on which</b>	<b>258758</b>
Annual interest liability @ 8.5%	21994
<b>Total balances held under Reserve Funds and Deposits (both interest and non-interest bearing)</b>	<b>261645</b>

But if the surplus cash balances lying idle and earning very little interest were utilized prudentially, it would have practically obviated the need for any fresh market borrowing by most states. Also since public account balances, being merged in the cash balance of the States, could be invested only in treasury bills, the option of investing them in other more attractive investment avenues is not available. This is bad cash management not only due to the negative carry, but also due to the soaring interest liability on account of increasing balances under Public Account heads; e.g. the annual interest liability of the states in 2012-13 on account of Provident Fund alone would be almost Rs 22000 crore.

But the most perilous and unpredictable consequence of this huge cash surplus would be its impact on the Union finances, because all cash surpluses from the States invested in treasury bills are automatically available to the Central Government and constitute part of its total financial liability. This is a huge reservoir of resources and temptation to indulge in populism at the cost of these funds is often irresistible, even if we have to ignore their inflationary potential. If these surpluses could be utilized pragmatically to finance the fiscal deficits of the States, the public finances in our country then would be a different story altogether.

It is high time the Public Account funds are separated from the cash balances and their management entrusted to professional managers free from Government control. Only then they would cease to be a drag on the exchequer, besides being open to misuse by Governments. To do so would not need any Constitutional amendment - only appropriate institutional and administrative mechanisms need to be created for the purpose.

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## References

<sup>i</sup> Constituent Assembly Debates, Book No 4, Vol IX, Lok Sabha Secretariat, 2009 Reprint, Pp 1191.

<sup>ii</sup> Ibid.

<sup>iii</sup> The other financial liabilities of the Government being its public debt liabilities and contingent liabilities on account of outstanding guarantees given to public sector entities and public bodies/ authorities.

<sup>iv</sup> Suspense temporarily accommodates all governmental/ inter-governmental/ departmental transactions pending availability of the requisite details in corresponding vouchers/ challans that would identify their final destinations. It also includes temporary investments of cash balances in short term loans or Government securities at nominal rates of interest. Remittances concern intra- and inter-Governmental cash remittances between its various departments / ministries and also between the RBI and the various Governments and Government Departments.

<sup>v</sup> Some of these funds - like the Sinking Fund, Calamity Relief Fund or State Disaster Response Fund etc.- have been created as per recommendations of the successive Finance Commissions.

<sup>vi</sup> Report of the committee on comprehensive review of the NSSF- MoF, GOI, June 2011, [http://finmin.nic.in/reports/report\\_committee\\_comprehensive\\_review\\_nssf.pdf](http://finmin.nic.in/reports/report_committee_comprehensive_review_nssf.pdf)

<sup>vii</sup> (Net Public Debt + Surplus in Public Account-GFD = Rs (129630+34807-161219) Crore.

<sup>viii</sup> Source: Finance Accounts of different States and Combined Finance and Revenue Accounts, 2010-11, prepared by the CAG of India.