**CSEP-World Bank Seminars on**
**India's Public Financial Management (PFM) System –**
**Post-COVID-19 need and opportunities for reforms**

# Session 1: Fiscal Governance

# Centre for Social and Economic Progress (CSEP)

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**Opening Remarks:**

**Vikram Singh Mehta** – Chairman and Distinguished Fellow, CSEP.

**Panelists:**

**N.K. Singh** – Chairman, Fifteenth Finance Commission

**Sean Dougherty** – Head of Secretariat, OECD Network on Fiscal Relations across Levels of Government

**Rajiv Mehrishi** – 13th Comptroller and Auditor General of India

**Yamini Aiyar** – President and Chief Executive, Centre for Policy Research

**Closing Remarks:**

**Junaid Ahmad** – India Country Director, World Bank

**Moderator:**

**Anoop Singh** – Distinguished Fellow

**For more details on the event:**

**https://csep.org/event/csep-world-bank-seminar-series-fiscal-governance**

*The following is an edited and revised transcript from the event. It has been generated by human transcribers and may contain errors. Please check the corresponding video for the original version.*

## PROCEEDINGS

**Vikram Singh Mehta:** Good afternoon, good evening ladies and gentlemen. My name is Vikram Singh Mehta. I am the chairman of the Center for Social and Economic Progress, and I am delighted and honored to welcome you all to our first webinar on India's Public Financial Management Systems. The subject of this webinar has been encouraged by the work done by the 15th Finance Commission which recommended bringing India's Fiscal Architecture to the 20th century. This is the first of three webinars that we will hold with multiple concerned stakeholders. I am delighted and honored and privileged to welcome Mr. N. K. Singh, who was the chairman of the 15th Finance Commission. And also, of course, four very distinguished panelists.

Anoop Singh, who is my colleague and Distinguished Fellow at CSEP, will introduce all the panelists in detail, but may I just say at the outset, first, may I congratulate Mr. Singh, on his election, as the President of the Institute of Economic Growth. He is the sixth president of the Institute, and he is the successor to five extraordinary individuals. The most recent of course, being the former Prime Minister of India, Dr. Manmohan Singh, who was the president for 28 years. Mr. Singh, you have been at the forefront of so many initiatives, I can only say with great confidence that the institute is more than likely to be taken to new heights under your leadership. So, congratulations, sir.

**N. K. Singh:** Thank you very much.

**Vikram Singh Mehta:** I'd like to welcome Junaid Ahmad, who heads the World Bank in India. He and his colleagues in the World Bank have been working with CSEP in building these three webinars. They've been very active in themselves, in developing aspects of India's Fiscal Architecture. We will hear from Junaid, but welcome, Junaid, and thank you for your support to CSEP. The importance of Fiscal Governance and the direction and the nature of public spending in India, especially towards infrastructure, has been brought into the sharpest of relief during this pandemic. And especially, of course, in India, where our resources are tight, and where we will have to be very careful in redirecting our expenditure. We need to look at tightening fiscal governance and in this context, we will have to build an architecture that brings together all tiers of governance; central, state, maybe city government, and along with the key stakeholders, which will include of course, the CAG.

And therefore also, I want to welcome my IAS batch mate and cadre mate, Rajiv Mehrishi, who was the chairman of CAG. I don't have anything other than to say that I followed his distinguished career for 35 years, but in absentia, since I left the IAS after two years. But Rajiv, it's a great pleasure to have you as a panelist on our CSEP panel. Thank you very much for being part of it. There is no doubt that India's financial management system has to be brought up to international standards, and I'm hopeful that Sean Dougherty of the OECD, will address that issue today. Welcome Sean, thank you also, for being part of us. Yamini is a colleague in some senses, in the think tank world, and I just want to extend my warmest welcome to her as well. So, without further ado, if I may pass this on to Anoop, and to take it forward in moderation, but I am delighted and grateful to all of you for being here and for being part of a CSEP webinar. Thank you. Anoop, may I just pass it on to you, please?

**Anoop Singh:** Yes. Excellent. Thank you so much. So, Vikram, it's a great pleasure and honor for me to moderate this. Let me just say that we have with us, as you have mentioned, incredible speakers. In some ways, we have speakers from India who have, in many ways, dominated India's fiscal architecture. We need no introduction to N. K. Singh as you said. Let me also say that I was privileged to work with N. K. with the 15th Finance Commission. He has covered probably all planks of the fiscal architecture, as the commission outlined – the three planks. In many ways, Rajiv Mehrishi as the 13th Comptroller and Auditor General of India, has been the leading spokesman on public financial management. I can't think of anybody else who we could have invited to speak on that issue, which is a key plank. The second plank of the three planks in the architecture as the Commission has outlined it.

Yamini Aiyar is very well known – let me tease her a little bit by saying that perhaps in many ways, she has functioned, informally, of course, as the Fiscal Council. And then, we have with us, Sean Dougherty, who has advised federations across the world and has also advised the 15th Finance Commission. I'm going to make one point. I think on the planks of the fiscal architecture we are talking about, it was definitely part of the terms of reference that the commission had got from the President of India; the principles of equity, efficiency and transparency, and how to improve public the efficiency of public spending. Let me just make one point before turning on to our speakers. And that is, I think, there's a common understanding over the years, what India needs to do to lift its fiscal governance and its fiscal architecture. The issue is this has many stakeholders. How can stakeholder consensus be built as outlined and recommended by the 15th Finance Commission? This will take years, not months.

Issue is, how can this be done? My idea is to first ask N. K. to speak before turning to Sean Dougherty on the international experience, and then, we'll turn to Rajiv Mehrishi and Yamini Aiyar. I hope there will still be time before Junaid makes concluding remarks, to have a discussion amongst us. And I should also say that those who are listening should please feel free to send the questions and comments through the Zoom box. So, N. K., please over to you.

**N. K. Singh:** Thank you very much, Anoop. Let me in the outset, thank CSEP under the distinguished chairmanship of Vikram, who as I mentioned to him informally before we started recording, has provided the leadership to many institutions, and has the ability and credibility to build institutions virtually from scratch. It has been my pleasure to know Vikram for two generations. And Vikram, you have indeed [cuts off] I can now see you, Rajiv.

**Rajiv Mehrishi:** Yeah, probably from my phone.

**N. K. Singh:** Oh, I see. Okay. All right. Let me say that I've had the privilege of knowing Vikram for two generations. His father was a very good friend of my late father, and I have also watched Vikram make great progress. I think this is, Anoop, as you said, quite a distinguished panel of very knowledgeable people. Let me at the outset, say I know what a pleasure it was for me to have you as a member of the 15th Finance Commission, which I had the privilege to chair, and to say that to a large extent, the focus of the 15th Finance Commission and its ability to address the rather complex terms of reference which you mentioned in the introductory remarks, owes very substantially, to the contribution made by you. And I think that in that process, you brought in significantly, the important role of the Comptroller and Auditor General of India, Rajiv, who has been also, a great personal friend of mine for number of years. I have watched Rajiv's own career with a degree of appreciation and to some extent, a degree of acclamation, if not awe. He brings the great knowledge which he has to the finance of the state, the finances of Rajasthan, the multiple offices which he held here.

I do not know if you know, that if it had not been for the efforts of Rajiv, they would have been greater complications in the 14th Finance Commission's recommendations seen by the light of the day. So, Rajiv brings the experience of an earlier finance commission to bear with knowledge of the states before he moved on, of course, to look after in terms security of India, and then of course, as the 13th Comptroller and Auditor General of India. Let me also say that, it is thanks to Rajiv's contribution, the

Comptroller and Auditor General, that some of the changes in the last budget, which we greatly acclaim, owes in substantial way to some of the recommendations made in the in the CAG’s report. Sean, let me say that you have been a consistent friend in helping and guiding evolution of India's fiscal strategy. I recall that, as the chairman of the FRBM Committee, whose recommendations, which I had also the privilege to chair, was accepted by Parliament in 2018. And in being able to firm up those recommendations for moving the meter from the earlier FRBM recommendations of the Act of 2003, to a more contemporary Act of 2018, you and the OECD, and the Secretary General of OECD made an important contribution. Since then, you have been an abiding friend on issues which will lead to fiscal policy.

With these few words, let me turn and be very brief. Anoop has already laid out the scenario why 15th Finance Commission was enjoined to fulfill its responsibility by addressing a very special term of reference, which was given to him, because it was a special term, the reference, insofar as it was given in the context of the changes in the FRBM legislation in the 2018 amendments introduced in Parliament by the late finance minister. And what was that core recommendation? That core recommendation was to move away the focus from fiscal deficit, to the focus of making debt as a primary macroeconomic anchor. The other important recommendation, which followed after the 15th Finance Commission's recommendation, was really to make the issues of general government more relevant and significant than central government as a whole. When the FRBM Committee of 2003 had made their recommendations, the focus was entirely on the issues of fiscal deficit of the central government, because at that time, the issue was India's track record of periodic balance of payments difficulties.

So, with that experience, we move forward to have the FRBM to, so to say, in 2018, which therefore changed the approach to bring in two important changes: one, the partnership with the states and the other on making debt a principal macroeconomic anchor. Also, I think that again, based on the experience which we do, we did put forward the overall architecture of public financial management reforms. And as Anoop mentioned per se, this is related to all aspects of public financial management reforms, which included not only state governments, but included the third tier as well. And therefore, from that part of who Yamini, whose participation today I greatly value, I have also known Yamini for two generations, and Yamini has done the earlier generation proud by the quality of work which she has brought to bear. And the quality of the presentations which Yamini made to the 15th Finance Commission was an important factor in shaping the thinking of this commission, particularly when it came to the third tier of the work of the 15th Finance Commission.

So, I now say two more things. First, I think what we need to do, is more or less well-known. What we need to do in terms of the obligations after the FRBM Act of 2018, we know. The recommendations in this part of the Finance Commission's recommendations on the fiscal trajectory, were in substantial measure accepted with some degree of alacrity by the finance ministry. If I may say so, with a little tongue in cheek, they clapped their hands accepting the recommendations in respect of the trajectory and the flexibility which I gave to states. But as far as the central government's own obligations were concerned, there was a degree of asymmetry in that treatment. They accepted a somewhat more stringent fiscal path for the states, but everyone can understand that given the pandemic, they wanted a little later time, with greater flexibility than which we had we had provided.

So, we have provided in this 15th Finance Commission recommendations, a roadmap for a comprehensive public financial management, and thanks to Anoop, we have included a draft legislation, which will require much greater consultations with all stakeholders, the center and the stage, to being able to generate the degree of consensus for putting this legislation into parliament, and then, as part of law. So, as I look forward, what are some of the five key challenges as it appears to me now? What you need to do has been articulated at great length in the Commission's recommendation. The recommendations are very specific. And what do we now need to do? What is the forward call? First, I think that I will be greatly benefited if you enlighten us on what are emerging global trends. The issue of the timing of the consideration of this important issue of fiscal governance is important. Currently, the world is engaged in dealing with the raging pandemic, it can hardly be said with certainty that this has been extinguished or permanently, the pandemic can't be taken for granted.

Uncertainties are large, mutations are arising, countries which thought they had fund, somewhat the war against the pandemic, are being forced to rethink and go to the drawing board. Plans and programs and overall financial management systems have therefore, from one point of view, conflicting views. The viewpoint of India, we must realize that there are as many economists as possible, not so for, on the issue that the sovereign has been far too practical in being able to give a fiscal stimulus. They are not wanting to regard the combination of the forbearance shown by the Central Bank governor in terms of loans, rollover, on the issues of liabilities, on the issue of somewhat more lenient framework on the lending operations to bank, as part of the direct fiscal stimulus. They would like the sovereign to do much more than it has done so far. So, the literature is full of wanting to prod the sovereign into much greater fiscal spending, than seems to be the appetite at the moment. The response of the authorities so far, has been that India's fiscal trajectory has been somewhat derailed from the part which they had accepted in the 2018 recommendations. And to lay down a new path, I think that would be problematic if much greater fiscal stimulus were directly given.

As it is, let us not forget the fact that, and Anoop knows this very well, so will Rajiv. That if you look at the total fiscal stimulus of the general government, it is right now, in the upwards of 12 to 13%. So, when some people advocate greater fiscal stimulus, I think we need to be careful, also, we need to be mindful. That if you look at the general debt profile is not worrisome, but the debt profile does not fill you with comfort, that, how are we to move in a credible way in the southward direction, and not in northward direction? And therefore, this issue of the timing on the next steps in fiscal policy is an issue, which is somewhat of a debate. The second is one of compliance. Not of new rules or regulations, but compliance to Acts and legislations already accepted by the government. For instance, one example obviously is, that having accepted the 2003 and reiterated in the 2018 FRBM Act, that for all deviations made from fiscal norms, there will be a very detailed explanation given by, at the time of the deviation by the finance minister to Parliament, outlining the reasons and then outlining more importantly, the timeframe and the retained parts to the fiscal consolidation roadmap accepted. I think that ensuring the compliance to this is somewhat significant.

Connected with this, is a more important issue. We know that following the recommendations of an earlier Finance Commission, all state governments had enacted State-level Fiscal Responsibility Act themselves. They had taken upon the Act, more or less, along the lines of the 2003 FRBM Act. But state governments have not responded to the far-reaching amendments, which were affected by the changes to the 2018 legislation. So, persuading, incentivizing, encouraging the states by using, I'm not using the word, 'misusing', but by using the instrument of Article 293, to encourage them to amend the FRBM legislation, would be one important medium-term objective, which really will give a better picture of the general government. I say this with some degree of confidence, because in the memorandum submitted to the finance commission, by the Ministry of Finance on this issue, Anoop, to tickle your own memory, one of the submissions, which they made was on a State-Level FRBM Act to the Central Government FRBM Act. And this is therefore going to be a challenge as we go forward. This was the third issue on the states.

The fourth issue is on the quality, consistency, and transparency of fiscal data. Now here, I think we owe a debt to Rajiv, who acting in his capacity as the 13th Comptroller and Auditor General, focused the attention sharply on the need to take into account, liabilities, which are off-balance-sheet liabilities, to take into account the issues of guarantee, to take into all the other factors, which have been reflected in the budget of the finance minister presented on the 1st of February. So, this is for the first time, that the finance ministry has accepted the fact that the data to be credible, must take into account all these off-budget liabilities. And efforts made by them in regard to the NSSF, is indeed commendable, which was a very important source of, opacity – if I may use, mind that expression. Issues of course, still on food subsidy, etc., remains problematic. But I take that Rajiv, I would like to hear on the future role which the 14th CAG can play and the role that Accountant Generals of the state can play in ensuring greater compliance to the spirit and to the latter, of truly credible fiscal data. This brings me to the last point.

My last point is that as you go forward, I agree this may or may not be the most appropriate time to discuss complex issues of fiscal governance. The appetite of the sovereign right now on this issue, is somewhat weak, and for understandable reasons, because at a time when they are under pressure for greater fiscal spending and greater fiscal stimulus, to talk in terms of fiscal consolidation, and fiscal tightening. But I think that it is recognized that once the pandemic is behind us, we will certainly need to have credible steps to return to the path of greater fiscal rectitude. Are we preparing ourselves adequately in this direction? That's my last consideration. And in the preparatory process, I feel three important steps are necessary. First, an important step, I think that the Standing Committee of Parliament on Finance, of which I was privileged to be a member, and I'd like to also hear a bit from Rajiv, that I was also a member for six years of the Public Accounts Committee of Parliament.

And I put it to you, Rajiv, that, can the CAG, in one of the reports, make this an issue for the consideration of the Public Accounts Committee in the deliberation? I say this, because we know that the standing committees’ matters are more advised. Recommendations which emanate from the Public Accounts Committee, have much greater force than the deliberations of both Houses of Parliament. And to take it forward, in what manner can we educate our parliamentarians much more and educate, apart from parliamentarians, state legislatures which have similar institutions, state public, and not all states have standing committees, but all states do have their own Public Accounts Committee. And therefore, not only the Central Public Accounts Committee, but the State-level Public Accounts Committee can have an important role which the CAG can play. My last thoughts therefore, are to address here on the international experience, Sean, in making this request, would you also inform us; what is the best international practice in getting sub-national governments and getting local bodies, which Yamini would speak, to be able to have a degree of conformity with the broad norms of an integrated financial management structure of things?

So, as we move towards technocracy, we must prepare the political economy for these medium-term daunting challenges on broader issues of Fiscal Governance. I stop here and thank you very much for this opportunity.

**Anoop Singh:** Thank you, N. K. Thank you very much. You raised important issues for us in our next two seminars. I think your last point about the political stakeholders, is the critical point. But before we turn to Rajiv and to Yamini, can I ask Sean to speak on the international experience, including at the subnational level, as N. K. just pointed out. Thank you.

**Sean Dougherty:** Well, thank you all. It's a pleasure to be here with all of you, and I think this couldn't be a more important topic to discuss. At the OECD, we have quite a few different committees that work on different aspects of Fiscal Governance. At the OECD, I represent the network on fiscal relations across levels of government, which India is a full member, and it's a pleasure to hear your broad range of thinking, Mr. Singh, about, and also the run up to the current state of affairs. I think the very careful thought and I think also political deliberations that took place to try to improve India's fiscal architecture, and I think there's been a huge amount of progress. And I think a lot of the progress is really on this panel today, in terms of the intellectual capacity, as well as the political impetus that has taken place. And I think this is really sort of, as a path of convergence to broader international standards and good practices, which is what we try to do at the OECD, is to collect these practices and try to facilitate governments, being able to share them and think about how they could move in the future.

And I would like to sort of, just start with one picture we have here that shows, I think, the complexity of the framework of modern budgeting. There are OECD council recommendations on this. But I think one of the key components here is captured in several of these hexagons, which is a kind of strong PFM law that underlines and can robustly support accurate comparisons across levels of government and can facilitate the supervision of sub-nationals, more particularly, states, by civil society, as well as by the central government. And I think this is very much behind the thinking of the draft PFM law and the fiscal councils, I mean, the Finance Commission's recommendations that I think are underlying the discussion today. And I'll just take up, I think, the three key areas that I think were raised in the background to the panel, and as well as by Mr. Singh just now. And I think the first is indeed, just the sort of overall fiscal architecture, and I think that should be underlined and reinforced, as in most OECD countries by a set of strong legal framework that's consistent, and particularly, at the national level, but of course, it needs to be, as I think was made very clear, at the state level as well. And I think without that kind of state level legislation, it's very hard to provide a good and comprehensive framework that can ensure the kind of consistency and comparability that you really need, when you're trying to improve on fiscal outcomes and try to compare, for instance, debt ceilings and debt targets.

One of the key components that we've done some analysis on at the subnational level on the operation of fiscal rules, which are I mean, a particularly key mechanism and tool for trying to keep fiscal sustainability at all levels of government. And of course, they can be used at the national level, they can be used at the state level, and they can also be used at the local level. And these usually have somewhat different configurations, depending on the level of government, partially because of their capacity to borrow, their capacity for the political economy dynamics, and the pressures for perhaps, spending versus debt. But in a typical country, we find that there's a layering, and there's different types of budget balance rules, there's borrowing and debt rules, there's expenditure limits, and often, tax limitations as well. And this is often reinforced by a sort of, a broader framework that includes monitoring and enforcement. Some countries, it's even self-enforcement; it's through civil society, and good traditions that these kinds of rules can be followed.

But in many countries, a stronger legal framework is necessary with the potential for the sovereign to intervene even more directly for those sub nationals that say, get out of line, or get into an unsustainable situation, perhaps through unexpected circumstances or a shock. And, of course, the relations with financial institutions are important as well, and being able to find out ways to deal with these kinds of unexpected, perhaps even disasters such as the COVID pandemic, and thinking about how they may have affected sub nationals, and I'll have a few comments on that as well, because we've done quite a bit of analysis at this block amid the pandemic. And I think some of the results have actually been surprising, and perhaps, we learned a lot from the global financial crisis. I'm just giving a quick overview of what we see in international experience; there's been a move towards a broadening of the number of fiscal rules that countries follow at the subnational level. The typical country actually uses three or different fiscal rules that complement each other. About two thirds, almost three quarters of countries that we monitor and that we've surveyed, including in this situation, and by the way we measure this actually, India fits in this category as well. And countries with each type of fiscal rule can vary quite a lot.

The Budget Balance Objective is the most popular and the most common, Expenditure Limits also can play an important complementary role and Borrowing Constraints are often in place as well. And we can also think about the stringency of the different fiscal rules. And of course, the formulas make a lot of difference, and some of them are quite complicated. I'm not going to get into the details here, but one thing that's also I think, interesting beyond the sort of, formulation of the budget balance rule is, you've got golden rules, and then you've got things that I think allow a little bit more space and take account of the macroeconomic dynamics more carefully. But then, you also have the accounting base of the rules, which actually can make quite a bit of difference even for the stringency of the rules. So, we have structural rules in many countries, which are more complicated to understand, as well as, to compute for outside observers, but they give a little bit more capacity to deal with unexpected circumstances. And some of them also operate over multi-years.

The annual rule, which is the most common, tends to be more stringent. And then, of course, we have the accounting basis, which I think it's great to have people with so much experience in this area in India. We don't have a lot of monitoring of the Indian case, but we do have some information that's quite interesting across countries. And here, that we have, actually, this was something we did just about two years ago, and the result was quite surprising, because I mean, accruals are quite popular at the national level, but in fact, it turns out that sub nationals, in some cases, were ahead of their central governments in terms of adopting accrual accounting. So, we found about two thirds of countries tend to use some version of accrual accounting at the subnational level, and this includes some emerging economies such as Brazil. This was a little bit surprising to us, in terms of, I think, there wasn't really information on this prior to our recent survey. And then, we have some other mixes of different approaches that we find in a number of other countries that where there's particular monitoring of some elements, but maybe still a reliance on more of a cash-based approach. And then, in terms of actually, the interpretation of the accounting practices, in terms of what indicators are monitored, those are not always the same. And well, debt is the main area to monitor – there are other metrics that are covered as well.

And I think, quite a bit of discussion as I already heard here mention a couple of times, the off budget accounting and off budget liabilities, which are often the area that is particularly easy to look over or to have an oversight on. And this is something where accruals can help to get a broader picture. Now, of course, it's not enough, really, just to put it in the rules in the accounting standards, we really need complimentary institutions that can help to reinforce and to ensure that governments actually follow these principles, and particularly, state governments where there's a lot more of them, and perhaps, there's not as much capacity in every one of them. And so, that I think, is a really important point. And let me come back to institutions in my last point, but just to point out in the context of the COVID crisis, that fiscal rules actually were lifted in many countries. And so, I think that's also something to be considered, of course. I think, as the chairman pointed out, this is something that is not surprising, but it means that the fiscal path that was envisioned a few years ago, may not be feasible at this point in most countries, and perhaps, we need to get back to a more sustainable trend in many countries as we begin and start the end to the pandemic and the crisis that was triggered by the very strong reaction by many countries in population.

So, the other thing that I think is important is that a lot of extraordinary grants come in across countries to support them during the pandemic. And all of this money that the central governments assumed and liabilities, will probably have to be gradually withdrawn. And the timing of that withdrawal, I think, is really critical. And then, how do you re-establish credibility of both the fiscal rules as well as the overall moral hazard problems of intergovernmental transfers? I mean, this is, I think, raises some really important questions. And I think that's even more important to think about the institutional architecture. So, let me finish with – I won't make a very strong pitch for this, because I think it's not so easy to come up with from scratch, but I do think that some institutions and it could be a single institution or could be a collection of, I would say, credible institutions, can create a kind of, sustainable and incredible fiscal architecture.

Fiscal councils became particularly popular, they existed before the global financial crisis, but they really came about more broadly and were adopted much more widely post financial crisis. And into the last decade or so, we, virtually all OECD countries, and certainly all EU countries, began to have some form of a fiscal council. Now, there are different kinds of fiscal council; some of them are very narrowly resourced, or narrowly constrained in their mandate. So, they may not all be the same, some of them have a much broader mandate and capacity. And then to be honest, in federal countries, it's actually not that common where they have a broad inter-governmental view. And I think that's maybe something that, well, we make recommendations quite often that that's something that should be looked at. But just to say, it's not so easy to replicate that institutional architecture at the subnational level. And so, I think some of the frustration you might feel for trying to get states to do that, may not necessarily be so easy to address.

One solution, which I think is interesting, is the Spanish example, when they have one of the most integrated fiscal councils, which has a sort of, broad view of not just horizontally, but also, vertically across levels of government, and so, it looks at the general government and as a planning, monitoring and enforcement mechanism at not just the immediate subnational or the autonomous community level, but then, also, the local community level as well. And that's in quite a complicated fiscal federal arrangement in Spain, which shows that even in a kind of, politically contentious environment, that it could still function relatively well. I can stop there for the moment, I just wanted to highlight a few key points and emphasize some of the international experience and challenges that I think countries face, to say that India is not alone in trying to improve its fiscal framework, but it couldn't be a more important job.

**Anoop Singh:** Great, Sean, thank you so much. Thank you, in particular for making it clear, the importance of applying the architecture to each level of government. So, maybe I can now turn to Rajiv Mehrishi, we're all waiting to hear you. You've been a dominant force in this, we look forward to your views, including as to what to do next. Thank you, sir.

**Rajiv Mehrishi:** Thank you, Anoop. And I will just dispose of with the formalities of thanking everybody, because it just takes time and we are short of time. I will also have to leave in about half an hour's time, 40 minutes' time as my mother is not too well and I will have to bring a doctor to her. So anyways, I must say that I'm extremely privileged, very privileged to be amongst a distinguished panel. And when I look at their careers and their achievements, I really find myself coming up quite short. I've been extraordinarily lucky in the experiences that I have gathered. I spent a long time for budgets in the Department of Finance in my state government. Then, I spent a year in the Ministry of Finance, Land and Building, and of course, a short-ish less than three-year tenure as the CAG.

This has given me an all-round exposure to look at the state of finances and what's happening quite closely, and I have some views regarding them. I read the report of the finance commission and its recommendations, and I want to speak largely on one aspect, one pillar out of the three pillars that they've talked about. And that pillar is about just keeping your accounts clean, just maintaining your accounts with transparency, and traceability. As a matter of fact, this has been of deep concern. This was of deep concern to us at the CAG. And what the CAG did about it is something which is not very well known; it's not out in public domain for reasons I really don't know. But that is what I will speak about today; what we did to try to clean up our accounting system. But before that, I'll just take a minute to divert on two little issues as they do relate to the recommendations of the various Finance Commissions.

The first is, there is the real problem that everybody faces, both in the federal government and in the state governments, about there being money relocations, and the lapse of money that takes place because of our long procedures, and very often, board interference in various standard processes. Now, we need to do something about it. And what sort of, scares me a bit, which I have reservations about, is doing non-lapsable funds as a solution to this problem. The reason is that you can't choose a system and then, you keep making exceptions; we made an exception for the North-east in the first place, and now, we are making it on ministry of defense. And I don't know where it will go next. So, my own feeling is that perhaps the solution lies and I'm sure other people have also suggested it before, the solution lies in doing some kind of adopting a new system, some kind of a two-year volume budget. So, any allocation made in the financial year, 2021-2022, should be valid for 2022-2023 automatically.

And of course, there will be heavy reviews to see whether any additions are required, or any deductions or cuts need to be done. So, that's something which is one of the constants at another time, but I think that we need to be very careful with non-lapsable funds, because they really promote corruption, as in the in famous PD accounts, which have become over time, non-lapsable funds. And it is, you know, virtually tens of thousands of Rupees lying in these PD accounts for years and years together. So, whether it's any state, some states are much better at it; they do less of PD accounts, while some states are really horrible at it and they have millions of PD accounts. And that money goes out of the process and remains unutilized or misused. Non-lapsable funds also promote laziness in the ministry for which it is granted. So, the alacrity reduces and the proof of that was the amount of money that is being gathered in the budget of North-east ministries. Finally, of course, the way that we do the non-lapsable funds annually, it does reduce the spaces of budget to the extent of the non-lapsable fund.

The second point is one which really deeply disturbs me, is us being basically an allocative regime. So, we just imagine that if we can announce an allocation for a problem, or we can announce a new centrally sponsored scheme, and I've said this in different forums earlier, government of India cannot give you a count of the centrally sponsored schemes it runs; there is no count on it. So, we just imagine that by announcing the scheme, some problem would disappear. And this experience is 40 years old, because of the infamous IADP program of the 1980s, or similar programs. We did not gain substantially, in reducing poverty or added onto the program, pulling people above the poverty line. Largely, those funds got misused, or at best, they gave some kind of temporary relief to the beneficiary. Apart from benefiting the other players in the game, which were the Sarpanch, and the bank manager. So, they are the major beneficiaries of the IADP program rather than the beneficiary themselves. Now, therefore, I find it strange that all our debates and all our learned academic papers only speak about when they speak of say, health and education, only speak about introducing the allocation to health or education as a percentage of GDP.

Now, without anybody ever asking or reflecting or stopping to ask, that are we at least, getting the kick for the buck that we are allocated? And I beg to submit that we are not. For example, a very relevant question to ask in the health sector is, no matter what your allocation is, is the structure that we have today capable of delivering health services? And that structure, most people who work in the health sector, and some of you might be surprised to hear this, that that structure was envisaged by an ICS officer in 1944. Now, we've been at it for the last 75 years, and we haven't even paused to ask that, “Is that structure, right? Can it work? Will it ever work?” Again, I beg to submit that the structure really exists; cannot work, cannot deliver even if we put 10% of GDP for health, because just dumping money or making more buildings or buying more equipment, doesn't deliver health services. That is essential for delivering health services, but that by itself, is not sufficient. So, it's important, it's needed, but by itself, is not sufficient.

So, the health sector is a disaster, and the same thing is about education. We have rarely been – there is no system that we have had in the last 75 years to really measure the learning outcomes that we ought to be measuring. So, we are still fighting a battle of yesterday, which is the battle of enrollment, but enrollment battle was won a decade back. And now, we really need to be fighting the battle of quality and that, unfortunately, there is no third-party objective assessment of learning outcomes. Again, I beg to submit that the education system, as it exists, has actually virtually destroyed three generations of Indians, because if you are educated in a government school, you are in a sense, disabled from competing with people like you and me. So, you are just being shut out of a whole salvo of opportunities. And there's so much hypocrisy in it, that you say that in government schools, education will be in regional languages, or in Hindi, because it's easy to learn in your regional language. But other examinations, whether it's Civil Services, whether it's Engineering, whether it is medical doctors, other examinations are on textbooks that are in English.

So, how does a child who has gone to a government school – and 20 crore children go to government schools in India. How does he compete or come to the standard of writing an entrance exam for higher education, when you have actually disabled him? So, somebody should have paused and asked and said, either we have to have not only examinations, but textbooks which are in regional languages or Hindi, or otherwise, we need to accept the fact that we can't do that and educate everybody, say, in English. So, other than that, of course, we know that we have had to depend on ASER to tell us, or an NGO to tell us how poor the learning outcomes are, or we have had to be embarrassed by PISA, and we have had to opt out of it; I believe we're opting in for it again, and the outcome will be the same. So basically, this problem in India of being an allocative regime, and very surprisingly to me, the politicians don't worry about this. They also imagine that allocating money or announcing a scheme, is a battle won.

As a matter of fact, it is just the beginning of the battle. The major battle lies ahead, and that battle, we don't really get into fully. Some people work very hard, write very detailed schemes sitting in their offices in Delhi, some of those schemes are not capable of working; one size does not fit all. And you can't write a scheme in Delhi and implement it across Arunachal and Rajasthan when they are two different geographies. So really, you need to think differently about the two states, which we don't. Now, coming to our major topic that I want to talk about, is that we, apart from the macro problem of not reflecting our off-balance-sheet liabilities, etc., our whole accounting system is actually a mess. There is actually no accountability, there is no traceability and there is no knowing also, whether the money has been spent for the purpose for which it has been given.

So, CAG does audit precisely for this reason, but I can tell you that CAG audits are just too remote, too late and too little to be able to solve this problem. Because CAG, by its nature, does only pilot kind of audit; it picks up departments. There are departments which don't get picked up for five years, and within the department, it picks up schemes. And if that department chooses not to give us those files and halt the continuation, then really, there's nothing very much that we can do about it. The number of misplaced files in government, especially when they relate to expenditure and payments, is actually quite astonishing. We are told there are misplaced files and then the CAG is working against a schedule, and therefore, those things get completely blacked out. So, what we were really worried about, you know, making this transparent; can we track expenditure? Can we trace it? Can we make it visible to everybody? And can we fix accountability? Can there be accountability for public expenditure and revenues? Through that, the fundamental pillar of democracy which is the accountability of public expenditure to the parliament, can be fulfilled. Mr. N. K. Singh spoke about the PSE, I'll come to that in a moment.

But as of today, frankly speaking, if I were the PSE, I would not be able to draw assurance that the money has been spent for the purposes for which it has been allocated. So, that is what it is about, as I said, it is about the form and manner of keeping accounts. Now, interestingly, the constitution makers foresaw this possibility, as they foresaw a lot of possibilities and problems. And they, in Article 150 of the Constitution, they provided that the form and manner of keeping accounts would be prescribed by the President on the advice of the CAG. Now, CAG has never given that advice in the last 75 years, but we departed from that. In March or April of 2020, we gave a detailed advisory to the President of India on what the form and manner of keeping accounts should be. This advice is one and a half years old; it is still not in public domain and is not as we discussed, which of course, disturbs me. But for some reason, it is not clearly in public domain. So, what is the problem with our accounts?

So, our accounts, the problem is, first of all, they're incomparable. You'll be surprised to know that no interest rate comparison is possible on such basic things as salary. Even that is as basic things as non-revenue expenditure. Every state seems to have its own systems of working rate expenditure and issuing rate expenditure. So absolutely, the accounts are incomparable, they're extremely obscure, they are so obscure, that you keep scratching your head not knowing what the money was actually spent on. So, I'll give you an example here also, that in the famous National Health Mission, another centrally sponsored scheme supposed to solve the health problems of India. We look at the provision, obviously, it sounds very good on paper, for any unforeseen expenditures. At various levels, they left various monies for that unforeseen expenditure. Some of that money was not used at all, especially at the PHC level, Primary Health Center or the sub center, because the compounder or the doctor there was too nervous of losing his or her job, not knowing how to keep government accounts, to spend that money.

So secondly, because it was meant for petty expenses like repairing a stethoscope or a blood pressure machine, but in a remote village, anywhere in this country, getting a stethoscope repaired is impossible; you have to get to a city to get it repaired. So, that money never got spent. At the state level, it translated into dinner parties at five-star hotels. So, that is the kind of misuse that takes place and gets booked as Development Expenditure or what used to be earlier called Planned Expenditure, and we can all feel very happy about the fact that there is so much planned expenditure going on.

Finally, the other very disturbing thing in obscurity is that, again, it surprised even some of you that almost as much as 25% of expenditure in several ministries' account in India is booked under the omnibus head, and other expenditure. And since we're talking about non-lapsable funds from Ministry of Defense, Ministry of Defense is actually the biggest defaulter in this. So, booking it as other expenditure, you really don't know where the money has gone, or what has it been booked. And though there is enough flexibility with every department and ministry to actually have the heads open, the subjects open, the object heads open, some of that never gets done and it gets booked as other expenditure. Third problem is non traceability.

So, I already mentioned this, that, you have misplaced files, but let me give you an example again. There's a concept of temporary advances in government. Now, there are thousands of crores of rupees in each state government, where temporary advances have not been accounted for as long as a decade, two decades, five years. So, if you don't account for advances, then really speaking, and there's no way of doing that, unless you can do it systematically. You just can't depend on paperwork for this. Similarly, there is also a concept in government, of contingent bills. And there are tens of thousands of

Rupees lying by people which are paid by us, and drawn by way of contingent bills, and no sort of detailed bills for that have been submitted or claimed. So, we really don't know where that money is, if the money is there or not there. Sometimes in our test audits, we do discover that some of that money has been misappropriated, defalcated, etc. But on the whole, as I said, we only do test audit, so no knowing; you have to be unlucky to be caught by the audit department, really speaking, because we don't have enough reach to look at every Rupee of expenditure that is carried out.

Again, this will surprise some of you, there is no standardized classification. So, for example, money given say, for example, for NREGA, actually gets booked under different states and departments, and depends on the department which is executing it. So, in some states, it's executed by the Agriculture Department, in some states, it's booked by the Rural-Urban Department. So, really speaking, there is no standardization of classification, and this is a very broad example. When it comes to this object head or the subhead, then the problem becomes even greater, because you have different people accounting for different things in different object heads. Now, there's no way of knowing whether you can do any kind of relation of account from that and know what you're spending money on. Now, what this does, actually is, this nightmare of account, is that this militates against good governance, it militates against good outcomes. So, I spoke about it earlier, that we don't measure outcomes. We should, because the way we keep our accounts for the public revenue/money, we don't have good outcomes. We will not be sure where the money is being spent, or if it’s being spent at all or not.

So, we thought about this problem in CAG, and we said what we need is not something incremental. We know something which we can do over 10 years, a decade or two decades, is something that we need to change fundamentally and completely. We need a sweeping change here, and we said that what we really look to use is IT lingo; we need actually, an enterprise-wide ARP and enterprise-wide computerization. We need to put all this money, all these systems, into an IT system, which are traceable and trackable. So, we said we need to have an enterprise-wide change in terms of how we keep accounts, whether it is a national government, subnational government, or the third-tier government. So that, of course, was the thought process behind us. And as I said, Article 150 of the Constitution gives us the privilege of advising the president. The article was very differently written by Dr. Ambedkar, where it gave that drive only of the CAG, but it got diluted in the Constituent Assembly, but that's another story, and Dr. Ambedkar was very unhappy about it, which is why we have a statue for Dr. Ambedkar in the CAG’s office.

So, what we recommended was that, there should be 100% – we wrote a detailed letter, and we include even more detailed note and advice, and we said that it has to be 100% data capture, which is end-to-end; from the time of budgeting to the time of actually invoicing and spending the money. And that this has to be both for expenditure and for revenue. For revenue, every activity that takes place must take place electronically; whether it's a notice, whether it’s a response. The current IT systems in the revenue departments are horrible. So, for example, the income tax departments system as it existed, we made a recommendation to change it. There could be a manual override without any audit trail. So, we had cases where on the file, it said that Mr. Mehrishi is liable to pay tax of 10 corrodes, and on the computer, it said Mr. Mehrishi is liable to pay a tax of only seven corrodes. So, it is astonishing that we should be so unprofessional about something as important as revenue. So, we said that it has to be 100% electronic data capture. And consequently, we have to therefore, determine the data elements that are required for each transaction, that are essential for each transaction. And we need to capture all financial data at the lowest level of granularity. So, that was the second point we made. And then we said that, because we have to define data elements, we need data standards.

So, we suggested that we have to set data standards, which are applicable to everybody and anybody who gets allocations from either the government of India or from the state government. Even if it's a non-government body, if it's getting an allocation, then, we need to have data standards required by the organization to maintain data with the data elements that are required to trace the major expenditure traceable and trackable. We also said that we have to include all entities; there can be no exception, we have to include all entities that receive government funds, whichever government allocate those funds, whether they are directly ministries working with the government, whether they are PSEs, whoever gets money needs to be in compliance with these data standards and these data elements. We also suggested that the entire system should be an open-architecture, and so, we actually suggested that there is an open-architecture prescribed by the government which is the end EA and we said that we should use end EA to create this system.

Then also, as a consequence, need to standardize definitions, standardize classifications, terms, formats and structures. So, as I've been at pains to point out, none of this today, is standardized. Different states follow different rules. Government of India follows its own rules. As of today, we spend 4,000 Rupees per annum across the state governments and the government of India in carrying out various transfers through banks etc. Bank Commission's is 4,000 Rupees per annum. We said that if you actually build a system like this, the saving on this account itself, would actually pay for the system that you are creating. Most importantly, we said that it will allow parliament to draw assurance that the money is actually being spent for the purpose for which it's allocated. So, now, the question was how to cover all the entities in this new system that we're suggesting for keeping accounts – one system for keeping government accounts across the country. And we said that you need to bring a law, the law is possible, a central law is possible because of Article 150, and that law would sort of, give them an outline of that law. We stole the name from the USA, Data Accountability and Transparency Act.

We said, this is the kind of law that we need to enact to first, enforce everybody to follow a standardized system of tracing and tracking accounts, that for everybody, it would be compulsory to follow and to ensure that there are timelines in which compliance is made. So, we gave them an outline of the law also. And that is now pending, I don't know where, but it's pending somewhere in the Government of India. Now, I'll just quickly respond to some of the points made earlier. The PSE unfortunately, Mr. Singh, is really part of its committees, it is really not able to cope even with the limited audit reports that we submit. So, out of the audit reports that we submit, the PSE itself select few. So, our test audits, they're themselves test audits, a select few of them get picked up for examination. Within that select few paragraphs that go for examination, and examination of those paragraphs have been pending for years together. So, there will be audit reports of four years back which paragraphs are still to be examined by PSE. And in any case, PSE has two other problems. One is that it doesn't seem to worry too much about macro indicators, they are always looking at particular schemes or particular projects, rather than macro indicators. And so, that report doesn't get discussed properly at all. And secondly, that unfortunately, as in other things, the positions taken by various members on several important issues are governed by the party they belong to. So, very rarely do we see a discussion, which is party-neutral.

So, then this issue of debt not being visible, that your liabilities are not visible, which of course, Ministry of Finance has agreed to pay from now on. There is another problem that is happening in the government of a recent origin that borrowings have been made by PSEs, by companies to carry out schemes of the government. So, capital and all sorts of borrowings are being used for every expenditure. And that, of course, is again, very worrisome, because it actually means that your accounts are not really fair; they don't really give a fair picture of what your expenditure or liabilities are. And then, finally, word of the state governments and the government of India. So, by and large, in spite of all their shortcomings, the state governments are actually, and again, this might surprise some of you, are actually better fiscally disciplined, than I suspect the government of India is. And the reason is that, because government of India controls the fiscal deficit limits of the state governments, so, they can't go beyond a limit. Government of India, of course, doesn't control it for itself.

So, therefore, I suspect that state governments, by and large, are fiscally much more disciplined, except with exceptions like Kerala, which has done something which is quite absurd, and that is, that they have created a new organization called the Kerala Infrastructure Finance Corporation with a specific purpose of carrying out development projects such as roads and bridges, and they make borrowings locally within the country and from without. And RBI surprisingly, has allowed that, though all external debt needs to be routed through government of India, this particular debt is not routed through government of India and they are creating this liability and they are not showing it as their liability. While building roads and building bridges is very much on the face of the government and is very much part of the capital expenditure, and it is something which the Kerala Infrastructure Finance Corporation has no revenues of its own, except budgetary support. And yet, the Kerala government likes to pretend that it is not their liability. Now, every year, they allocate money for the repayments due, and at some point, this will give way, at some point, the Kerala government won't be able to sustain that debt. And then, we'll have really, the whole house coming down because really speaking, and the Government of India will wake up and see that they have an external debt that they haven't accounted for in their own books, and what is happening off their books also.

So, we did submit an audit report on this, and the Kerala assembly got very annoyed with us, and they passed a resolution saying that this report will not be discussed in the house. Now, that is the other problem that we have in the system, that ultimately, no system can be better than the policymakers – the people who run it. So, if nobody wants to take notice of something quite absurd like this, then really speaking, no matter what system you put in place, that system is going to have only limited value. So, this is all that I have to say at this point of time, and I'm here for 10-15 minutes more to answer any questions.

**Anoop Singh:** Thank you very much. You brought up such important issues, you have also addressed some of the questions we got in our box. So, I can't thank you enough for all that you said, but please, let's move on to Yamini. And I do think we're going to go beyond our 6:30 timing, but I think it's fine if it goes slightly beyond it. So, over to you, Yamini, and then, we move on to Junaid. If we miss on things, some questions which have come to us, we'll do them in our next two webinars. Over to Yamini. And first sorry, before we do it. Rajiv, I want to give you our best hopes that your mother would be fine, her health is okay, and she will recover. Thank you so much for doing this while you're taking her care.

**Rajiv Mehrishi:** Yeah, she's 88, so, it's a little, you know.

**Anoop Singh:** Yamini, please, over to you. Thank you.

**Yamini Aiyar:** Thank you. Thank you so much. I know it's an absolute privilege for me to be here amongst mentors, people I've learned from and deeply admire, and a real privilege for me to have the opportunity to once again, learn from you. Every single thing that Mr. Mehrishi was saying before me, really hit home. It hit home because about a decade ago, I came up with a foolhardy idea of trying to trace the flow of funds from government of India to a school bank account for elementary education. It aged me by many, many years, and the only way in the end, that we were able to do this, by the way, was to put in a set of questions into the annual ASER survey that you mentioned, that traces learning outcomes; it's a nationwide survey that hits about 30,000 schools across the country. And we had to plant questions in there, and when we were doing the training with the surveyors, they said to us, but usually when we do surveys, we go out to track information that doesn't exist.

So, you're asking people questions, here, we were saying, Go and look at the schoolbook of accounts, because they all have registers, vouchers, etc. And all you had to do was to copy and paste those into the survey form. So, this is a unique survey where we are actually collecting information that already exists. And that's the strange reality that there is information that exists across all levels of government; on public finances, on allocations, on the flow of money, on expenditures, but it exists in ways that are non-standardized. So, this issue of standardized accounts that Mr. Mehrishi was talking about, even to figure out how much is spent on education by the Government of India is not such a simple exercise, because you have one account head for what's being spent by the school education department and then, you have to go to the Ministry of Tribal Welfare, Social Welfare, etc., because different departments have different schemes, all of which has to be pulled together. Then, if you compare it with the RBI that has school education; arts, culture, sports, all clap together, your number will not add up with the RBI number, then, if you go down and start comparing states, the lack of standardization creates its own problems.

So, it really is a maze. And it's in that maze that the entire discourse on public finance management has to be placed. Mr. Mehrishi spoke of the importance of using technology as a mechanism by which you can create an end-to-end public finance management architecture, I wholly endorse that. In fact, that's something that we've been pursuing a lot in our own work, to build up a real time budget platform that allows for traceability and for being able to track expenditures from the point of allocation, all the way to expenditure, at the expenditure entity. It will ensure deep transparency. But I fear that that's only a very thin edge of the bigger problem. And I think the bigger problem has everything to do with both our political economy, but also, the culture and structure in which we think about public finance management and the question of accountability. Ultimately, public finance management systems are about accountability. And the challenge is, to borrow from Lant Pritchett, we tend to conflate accounting for accountability.

So, even as we speak of the importance of tracking outcomes, we reduce outcomes into line items, and then, we want to track the exact way in which each line item is spent level by level. And any amount of discretion given to any level of government is tantamount to the possibilities of undermining accounting accountability. And therefore, we impose new layers, new rules, new line items, and make a whole process of public finance management, a labyrinth of rules, all in an attempt to tame this Leviathan, which actually will find some way to get around the rules. But it makes basic everyday governance and expenditures really hard. Take a simple example, Mr. Mehrishi was speaking about the National Health Mission. The National Health Mission in 2005 or 2006 when it was first launched, rather sensibly said there have to be five budget line items. And then, there will be discretion at the state, the district and the local level for how it wants to move its money around these items and spend according to local needs.

Today, it has 2,000 line items, and to move expenditure from one Excel box to the next, the file has to go through in U.P. 22 departments, in Bihar 32 desks, and in Rajasthan 25 desks, to get clearance for the Treasury to start releasing the money. In that process, you tie the hands of every single level of administration, all in the name of accounting, transparency, addressing corruption, but what you're left with, is a complexity of rules that essentially undermine the possibility of mapping expenditures to outcomes. So, I think the first thumb rule for how we have to think about public finance management systems, is to reframe our discourse on accountability; a public finance management system, whether it deploys technology or not, whether it becomes transparent or not, but one that layers rule upon rule upon rule and ensures that every single file goes to 32 different departments, essentially is a public finance management system that is designed to fail.

So, we definitely need the institutions; there is no argument there, we definitely need technology. But embedded in that has to be a complete cultural shift in what we mean when we say public finance management, is this management of accounting period? Or is it management of accounting to arrive at a sensible outcome and accountability for that outcome? And it's, I think, in that context that, we should be also discussing the question of fiscal rules. Dr. Singh made the important point at the start of our conversation, in the context of the pandemic, everything that we know about fiscal rules is sort of, off the table. And India, of course, decided that we will take everything that we know about fiscal rules and put it on the table in the midst of the pandemic, so we were much more careful about how we spend, but really, the question about rules should not be only about fiscal deficit or debt to GDP ratios, it has to be what is the outcome? If you know what you are borrowing for, and if you are borrowing to address a specific set of outcomes, and the government can credibly signal that it is moving in that direction, there will be a lot more flexibility.

So, rules, again, are not rules to tie you down to targets. Rules are to ensure discipline that map actions to outcomes with full transparency. And for me, that's why fiscal rules matter and that's why a midterm fiscal framework that should be at the heart of discussion on fiscal councils, or rather, what a fiscal council should do, is so central to our discussion on public finance management systems. The third point I wanted to make; when we talk about public finance management systems, we often talk about the federal structure and the great frustration, because the center imposes the same tightness on the states and the same sort of tight fist and refusal to loosen its purse strings vis-à-vis states, as the states do with local governments. We've often, and I think, the finance commissions, consistently over finance commissions that I went back to the 13th chapter of the 15th Finance Commission report, really just to, in advance of our conversation, and now, since about the 10th Finance Commission, every finance commission, every five years, has the same lament, and in some senses, the same version of a solution to the problem.

The lament is that we need to ensure that we have robust accounting systems from the bottom up, and it is crucial that we have good accounting practices and standardization of our accounting systems from the panchayat upwards. And that the finance commission finances could be a lever to both empower local governments to do this, but at the same time, also work as a carrot and stick where it uses its conditionalities as a stick, to be able to ensure that local governments in fact, do this. I started my foray into public finances about 20 years ago now, almost, in the World Bank, were one of the things that we were trying to do was precisely this; figure out how best to ensure that we have high quality standards of public finance management systems in the third tier at local government level. And in principle, there's absolutely no quibble with it; this is exactly what we should be doing, except that the only thing that's changed from when I first started looking at local government finances is that I've grown older and a little greyer, the local government finances stay in the same disarray as they always have been and finance commission after finance commission, impose conditionalities and lament the lack of quality audits from the bottom up.

Perhaps, one way of thinking about this is whether or not state governments have been able to adequately capacitate local governments, and by that, I don't just mean, technology, I also mean the human resources. So, if you have one panchayat secretary handling five different gram panchayats, you can have all the technology of the world, but the ability to actually maintain high quality books of accounts is absolutely limited. The Rural Development Ministry had a report on state capacity and highlighted how little human resource infrastructure there is at the grassroots level. So, I think it's important for us also to recognize and get real when we talk about public finance management systems, we also need to talk about state capacity for public finance management. This means human resources from the grassroots up, the DDO, the Drawing Disbursement Officer who sits at the district and sometimes, at the sub-district level, is an overworked person whose office is full of files and papers with absolutely no support. We layer on to this a data entry mechanism because now, technology is being built into the system without thinking even about simple things – what does it mean to have data entry operators?

Now, this goes back to fiscal rules, because ultimately, hiring more means that wages and liabilities for state governments are going to be high. And that adds a lot of disincentives at the state government level to bring in personnel. So, what I'm trying to sort of, get to is, when we are talking about public finance management systems, we need to broaden our horizons, to talk about public finance management systems in terms of rules links to outcomes, and institutions in that context. We need to interrogate how we think about accountability, and its relationship with accounting, and it needs to be placed in a larger discourse on what will it take to build a state capacity, not just in terms of the kinds of institutions, but the capabilities of those institutions to do the jobs that they want. Else, we'll end up with institutions, rules and laws, that may create perverse incentives. And I think the FRBM of 2003 did create perverse incentives for states. I don't have an empirical way of proving this, but it did create a large body of contract workers, who ended up going to the courts for permanent jobs, and in the end, we basically got a lot of court cases, and a lot of permanent workers, racing the courts to try to resolve those court cases, and not in our state capacity at the grassroots where we needed in order to be able to get to the sophisticated discourse that we want to have on our macro-economic framework.

The last point, we also need to shift this discourse from talking about this at a national level, to also bringing in states, and the state enabling environment for this discussion, just one number. State legislatures get somewhere between 24 hours for the bulk, and about three to four days for others, to discuss state budgets. They do not have any support structure that they need to be able to debate. The state budgets are difficult to get and some state legislatures have now started putting budgets on to the tablets that MLAs have. So, it's not available in the public discourse; so, there's no environment in which budgets get discussed. By the time we start looking at state budgets, and we talk about them, we are already in August, which is the start of the next fiscal cycle. And so, the opacity, the gaps between budgeted expenditures, revenue expenditure. This year, the states seem to be so clear that they're going to go back onto a path of fiscal responsibility. It's just impossible to believe. Somebody just sat there and worked the Excel file. The only way to debate this is, if this data comes out in the public domain, so, machine readable state budgets, please, and you will get a lot more people at CPR, analyzing them to be able to push the discourse a little bit further. So, I'll stop there, but there's much to debate on this very, very crucial and important issue. Thanks, Anoop, for starting this conversation.

**Anoop Singh:** Yamini, thank you so much. You raised so many important issues. I wish we had time to discuss some of them more. We'll do it in the next two webinars but thank you so much. I think you have also addressed – we've got a whole host of questions in our box, but I do believe you have addressed many of them. Let me just say that if I might be so bold to say that by what is called, Indian Standard Time, we are not doing too badly. But having said that, can I turn to Junaid and ask him to take over and to conclude this with his remarks that I also look forward very much to hearing. Junaid, over to you.

**Junaid Ahmad:** Anoop, what can I add to what has been said? I think one has to be very careful in trying to conclude from the wise words and the deep words that have come out from our different colleagues. Let me perhaps suggest the following. I think the 15th Finance Commission's report on PFM, and the comments of each of our colleagues here today, clearly indicate that there is an expenditure side reform process that is needed, but it's a reform process that can't be addressed scheme-based. If we undertake reforms on the expenditure side on a scheme-based mode, we're not going to shift the game. And if that game has not shifted on the expenditure side, the outcomes that everyone is talking about will not happen. I mean, every one of the speakers has talked about fundamental, institutional, rules-based, enterprise approach and culture-based changes. These are not soft words; these are really demanding for a fundamental shift in the way India must look at expenditure processes.

So, my question to you, Anoop, is what have we learned about change processes in India, that gives you a sense of how to take forward expenditure reforms, system-wide? I really think that your approach of opening conversation at different levels, first, this conversation, putting financial management in a fiscal governance framework, you immediately said it's not a scheme called PFM, it's part of a fiscal architecture. Next, moving the dialogue to the state level, I think that these dialogues have to be part of the change process that you want to trigger, because without it, it's not going to happen. We are all looking at the pandemic and taking lessons from there. I think there's one lesson that I take away is, over the years, I've come to respect the political economy of change, quite a bit. And I've come to say, there are certain things that we can do, and therefore, we must do, and let's move the bar on. But what we've not done enough is to say, “What's the cost of doing incremental change?” A pandemic made it very clear that the health reforms that India is doing has been in the right place, but its pace of change has been so slow, that when the pandemic hit, the cost of that inaction over the years has just been horrendous. Often, we don't see that cost.

So, if we go at the expenditure reform on a scheme-based incremental approach, the actual cost on the economy, the actual cost, in terms of giving up on accountability, is going to be very high. So, my only comment is not to repeat what I think are the valuable points made, both in the finance commission's report, and the points that have been made by the different speakers. And I very much endorse the final point on state capability. My question is, as you take forward this conversation, please push the story of, “Where are the triggers of change going to come from?”, and let's invest in those triggers of change. And I sometimes feel that the dialogue that we bring, has to bring a little more, those who have gone through political reform processes, and to ask them to share with us, where are the triggers of these changes? Because without understanding it, expenditure reform will fall prey to the very problem that it faces, that it's all scheme-based, and we cannot any longer go at it, scheme-based. Anoop, over to you.

**Anoop Singh:** Thank you very much. I think all your points are taken. We have two more webinars. I take from many of you, the fundamental point; we need to extend this debate if we're having to the political stakeholders. I think it's very, very important. I can't thank our four speakers enough, and Vikram and Rakesh and Junaid, I think it’s a tremendous start. Thank you all. And Vikram, do you want to say a word before we conclude this webinar?

**Vikram Singh Mehta:** No, I just wanted to say this has been extraordinarily rich conversation, and I thank everyone who has contributed. So, I look forward to the next two webinars. I think it's going to be really exciting to see how we take it forward. But once again, thank you, all of you for having come on a platform hosted by CSEP. We are all very grateful.

**Anoop Singh:** Thank you all.