

M.P.L

RARE BOOK

A
DISSERTATION
for the
MASTER DEGREE OF ARTS
in
ECONOMICS

in lieu of three papers

on
PAKISTAN'S
BUDGETARY STRUCTURE
AND
CLASSIFICATION OF ACCOUNTS
for
Economic Analysis

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INTRODUCTION

An analysis of the budgetary policy of the central government of Pakistan during the last nine years was the subject originally selected for my research work. An examination of the budget documents, however, revealed that the existing pattern of presenting the budget accounts does not lend itself to any satisfactory economic analysis, as it is very largely dictated by administrative considerations rather than considerations for economic analysis. Before proceeding with the analysis of budgetary policy, therefore, it was necessary to rearrange the budget accounts so as to reveal the true economic nature of the items of transaction. But here again another difficulty confronted this attempt: the information provided in the budget statements and supplementary statistical documents was not sufficient for the purposes of 'economic reclassification' which would therefore require data not officially published. As a result the whole attempt to analyse the budgetary policy of the government had to be given up, and the question of budgetary structure and classification of government accounts of Pakistan from the point of view of economic analysis and policy was taken up instead. It needs hardly be said that the significance of the structure and classification of budget accounts for economic analysis lies in its role in providing economically significant information about the government transactions, and that for economic policy lies in its role as an instrument of economic planning.

The work that finally emerged therefore centres round the presentation of budgetary accounts of the central government

of Pakistan. The questions that have been sought to be answered during the study may be outlined as follows: first, what a central government budget should furnish if it is to be typically suitable for purposes of economic analysis and policy; second, in what respects does the existing budgetary structure of the government of Pakistan fall short of these requisites; third, in what way can have the accounts of the government to be prepared and presented so as to satisfy the said requisites; and finally, what is to be the fate of the existing pattern of budgeting once a new way of presenting the budget accounts is adopted to satisfy the needs of economic analysis and policy.

The framework that has been suggested for what has been termed as 'economic budgeting' has been formulated in the light of principles of modern budgeting found in up-to-date economic literature, with alterations and modifications according to the character of Pakistan's economy and the position of the central government sector in it. The tools of analysis have been supplied mainly from three books, viz., 'The Problem of Budgetary Reform' (J.R.Hicks), 'Budgetary Structure and Classification of Government Accounts' (U.N.O.) and 'Budget Management' (U.N.O.). A study of the description of budgetary structures in Italy, Sweden and U.S.A. provided in 'Budgetary Structure and Classification of Government Accounts' has helped the analysis substantially. Finally, the knowledge in accounting was derived almost wholly from such standard text-books as 'Advanced Accounting' (Batliboi).

The plan of the study is as follows: requisites of economic budgeting and a solution by showing the possible role of central government

Chapter one is intended to provide a groundwork for the study; it sets out in some detail the need for an 'economic budget' for the transactions of the government of Pakistan, and adds a brief history of the development of the ideas of modern budgeting in practice as well as in theory.

Chapter two is a critical study of the present budget system of Pakistan in so far as it serves or falls short of the needs of the economist for his analysis and of the planner for his economic policy.

Chapters three, four and five set down the requirements of an economic budget for the government transactions in Pakistan. Specifically, the problem of bringing in of the whole of the government sector under the jurisdiction of the budget, so that the budget can offer a complete picture of the transactions of the whole of the government sector, is studied in chapter three under the head 'The Problem of Comprehensiveness'. The problem of an appropriate line of demarcation between the current and capital accounts in the budget, so as to provide an analytically significant meaning for budgetary surpluses or deficits, is taken up in chapter four. Finally, the problem of classification of the transactions of the government in accordance with their respective economic characters is studied in chapter five.

Chapter six attempts at finding out the place of the existing budget system of the government of Pakistan once 'economic budgeting' is adopted.

Finally, chapter seven summarises the requisites of economic budgeting and concludes by showing the possible role it could play

in the formulation of a five-year plan for Pakistan, the draft of the first five-year plan having come out before this work was completed.

An appendix has been added in the end which attempts at economic reclassification of Pakistan's budget for the year 1955-56 with a view to finding out the economic significance of the transactions estimated in the budget.

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CHAPTER I

A NEW ATTITUDE TO GOVERNMENT BUDGETING

"The success of a systematic economic policy is conditioned by the successful solution of the budgetary problem in the wider sense."

---Mrs. U.K.Hicks.

1. Two-fold significance of a budget

The administrative significance:

A central government budget has two aspects. The first is from the point of view of the administration of government monies received and disbursed. The significance of the budget from this point of view lies in its use as an instrument to control the financial operations of the numerous government departments. The need for some such instrument of control arises from two considerations, as explained below.

First, in the absence of some form of control, there would be a tendency for each individual department to incur and accumulate debts of its own, for it could borrow on the general credit of the government. This would obviously make things uncomfortable for the finance minister. Furthermore, a government department might spend its funds quickly or slowly, as it would find convenient. It might spend all the proceeds from borrowings and other sources of revenue in a single year, or it might keep off a large portion of the same for expenditure in future years. There is nothing inherent in doing so that might make it appear unsound or dangerous. But if each government department pursues a financial policy of its own according to its own convenience only, without any regard to the general financial position of the government as a whole, it would be impossible for the government to have any general financial policy. For then the expenditures of the depart-

ments could not be controlled, and might not even be easily ascertained.

Second, in a democratic state the ultimate dictator as to how government money is to be raised and spent is the people, whose voice expresses itself through the legislature. The financial transactions of the government, therefore, must conform to the decisions of the parliament. The latter will decide upon the means of raising government money and choose between the various demands for government expenditure. The activities of the revenue collecting departments and the spending departments of the government must accordingly be controlled so that money is raised and spent in the way exactly as chosen by the parliament.

These two reasons necessitate the existence of some instrument by which the financial operations of the government departments may be effectively controlled. This gave birth to the concept of budgeting. The traditional function of a government budget is to ensure that the numerous government agencies are not allowed a loose reign in respect of financial matters, and that money is raised and spent in the way planned by the legislature.

Generally, there are three chains in the form of control exercised over the financial operations of the government departments through the budget. In the first place, the revenues of the government covered by the budget are regarded not as belonging to the respective individual departments that collect them, but are all carried to a central pool called the Treasury. In the second place, the needs of an individual department have to be met by allocations from the treasury in the way as laid down in

the budget. Finally, no individual government department is empowered to borrow or lend in the open market, all such operations being undertaken by a single agency (the central bank) on behalf of the government as a whole.

In order to ensure that these chains operate in practice, a certain system of machinery exists in every country whose task is to translate the provisions in the budget into action and acting as checks against any operation not in conformity with them. The agencies constituting this machinery range from Public Accounts Committees elected by the legislature to the Executive Government, the Department of Finance, and special Audit Departments.

One aspect of the government budget is, therefore, that it enables the legislative 'power of the purse' to be exercised over the various government agencies.

The economic significance:

The second aspect of the budget lies in its relationship to the national economy. Every financial operation has its effect, small or large, on the market and as such on the economy as a whole. The financial operations of the government taken as a whole has substantial effects on the economy because of the largeness of the state as a financial unit. Regarded as a giant financial unit, the state by its transactions exerts significant influences on the market prices, employment, and the magnitude and distribution of the nation's wealth and income flows.

In the realization of this importance of the state

in the economy lies the genesis of economic planning. Economic planning is nothing but an attempt to manipulate the influence of the government's financial operations in order to achieve a desirable complexion of the economy.

This manipulation, again, needs the government budget as the main instrument. Since the budget reflects the financial operations of the government, it serves as a direct guide to the effects of the same on the economy. Not only that,-- by altering the allocation of money to the various spending departments through the budget, and by choosing between sources and methods of raising and earning money, it is possible to lead the economy almost towards any desired goal. The budget, therefore, is an invaluable tool for economic planning; it serves as the virtual mirror of the plan.

Significance in underdeveloped countries:

This significance of the budget as an instrument of economic planning is all the more important for the underdeveloped countries of the world where economic planning by the state is an indispensable condition for any respectable rate of economic development. Development of an underdeveloped economy may be identified with capital formation. For it is capital that produces income in the real sense, so that increase in the national capital increases the national income and hence develops the economy. Now capital formation cannot take place without saving. But, in the first place, the poverty of an economically underdeveloped community makes it well nigh impossible for saving

to take place at a significant rate. The widely spoken of high marginal propensity to consume of the people acts as the bottle-neck. Keeping aside the question of foreign finance, it is the state that has to come to the rescue. If the state is regarded as giant firm carrying out the largest financial operation in the country, it can be said to have the capacity to 'save' just like an individual or an ordinary firm. Government expenditure and revenue may be regarded as counterparts of private expenditure and income. If so, then one of the important ways in the line of state activities by which the state can help economic development of the country is obviously by saving through the public fisc, i.e., by showing an excess of current revenue over current expenditure. By so doing the state can have a positive contribution to the economy's saving. And in the interest of economic development the government should try to make this contribution as large as possible.

In the second place, it is common knowledge today that for various reasons, such as lack of sufficient basic facilities available for industrial enterprises, private entrepreneurship cannot be expected to contribute much to capital formation of an underdeveloped economy. The state, therefore, has to shake off its traditional prejudices against public enterprise in industrial activities. It has to take up in its own hands the task of capital formation until at least private enterprise can venture forward at a significant rate. In particular, the

1. The definition of current revenue and expenditure appropriate for the public fisc in an underdeveloped country will be given in chapter four.

state has to step in to develop the basic facilities like power, transport and such others without which an industry cannot grow up.

All this makes the government budget a very important and powerful weapon in planning for economic development of underdeveloped countries. For it is the budget that shows how government money has to be raised and spent. In the context of the role of government in economic development, therefore, a good deal of care has to be exercised in preparing the budget estimates.

2. A New Attitude to Budgetary Structure and Classification of Govt Accounts

Traditional budgeting:

As we have seen, a budget has its significance from two points of view. To the administrator, it is an instrument to control the financial operations of the government departments; and to the economic planner, it is one of the major tools through which the plan may be implemented and executed.

Traditional budgeting in almost all countries has overlooked the second significance. This is because the role of the budget in economic planning is of quite/^arecent origin. The idea of economic planning itself does not date farther back than the Great Depression except in Soviet Russia, which has a different politico-economic set up altogether. In the capitalistic countries of the world, economic planning has been given attention to mainly after the works of Keynes in Great Britain and Hansen in the United States during the thirties, and a further spur has been added to it after the second Great War. It is no wonder,

therefore, that traditional budgeting should show no signs of recognising the possible help the budget can render to the economic planner.

The need for (a) economic character classification:

In order that the budget may serve as an efficient instrument in planning, it is necessary, first, that it should be presented in such a manner as to help analyse the effects of government transactions on different economic phenomena in the economy. It is only when the effects of different ways of raising and spending money are understood that the question of 'planning' or choosing between them becomes relevant. This requires what is known as ECONOMIC CHARACTER CLASSIFICATION of the receipts and expenditures of the government. Economic character classification implies that the items of transaction are classified according to their respective economic characters. For example, a receipt should be classified according as it is a direct tax or an indirect tax (if it is a tax revenue), as its effects on the economy will be different if it is one rather than the other; similarly, an expenditure has to be classified according as it is an expenditure on some good or service for current consumption or for the acquisition or creation of some capital asset. In contrast to this type of classification, traditional budgeting provides what may be generally called 'administrative classification', i.e., a classification designed for the exclusive convenience of the administration of public money; in other words, it is a system of classification that merely serves the.

first purpose of a budget which we have discussed at the outset of this chapter. For example, a receipt which accrues to the Department of, say, Land Revenue, concerned with the collection of land revenue and supervision of land, will be classified under the head 'Land Revenue' irrespective of whether it is a tax revenue paid by the land owners, or a receipt from the sale of government land, the sale being effected through the Department of Land Revenue. It is obvious that the administrative classification cannot serve as a guide to the economic effects of the transactions inasmuch as it mixes up transactions which have diverse effects on the economy.

(b) Conformity with national income accounting:

Second, mere economic character classification of the items of transactions is not a sufficient prerequisite for the usefulness of the budget in economic planning. The classification should at the same time be such as to fit into national income accounting. The importance of national income accounting has mounted along with the development of the idea and importance of economic planning. The ultimate aim of economic planning in a modern welfare state is two-fold: (i) to increase the standard of living of the community as a whole, which in tangible terms means the increase of the national income; and (ii) to lead the economy to a more equitable distribution of the national income than at present exists in most countries. Both of these require an estimation of the national income before and after any period covered by the plan. Whatever method of computing

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the national income is followed, the earnings (in the income method) or spendings (expenditure method) or both (where both income and expenditure methods are used so as to provide for mutual checks) of the government have to be taken into account as a matter of course. The task becomes greatly facilitated if the budget can directly show the economic earnings and economic payments of the government separately, as contrasted with the transfer earnings and transfer payments. It is the former that are relevant for national income calculation, for the latter cancel out when the aggregate transfer earnings and transfer payments *(between bodies & individuals within the country)* of the government are computed.

(c) The need for comprehensiveness:

Finally, a new attitude is also necessary as regards the coverage of the government budget, i.e., the number and type of government departments and agencies whose financial transactions have to be reflected in the budget. In order to offer the government maximum latitude in preparing its plan for the economy and implementing the same through the budget, it is necessary that all the departments and agencies over which the government has direct control should be brought under the purview of the budget. Thus, the budget should reflect the financial transactions of the nationalised industries and agencies carrying out public utility services along with those

2. The increase in national income has, of course, to be estimated after allowing for the changes in the value of money over the relevant period.

of the purely administrative departments. In underdeveloped countries in particular, governments are today sponsoring a number of public or semi-public bodies to carry out specific developmental programmes such as providing industrial finance to private entrepreneurs or directly taking part in some developmental activity (such as the P.I.D.C. in Pakistan). No government plan for the economic development of these countries can be complete unless the activities of these special agencies are taken into account. If we have accepted the budget as the main and most important reflector of the government's economic plan, it is only logical to conclude that the financial operations of these bodies should also have a place in the budget.

This is something not accounted for in traditional budgeting. In most countries the government budget is mainly concerned with the administrative departments, and where some or other government agencies of the nature of an enterprise are included, this is done as a matter of convenience and not as a point of principle.³ The need for a new attitude in this direction is, therefore, emergent.

The inclusion³ of the transactions of government bodies of the nature of an enterprise will, however, raise new problems as regards the relation between the Treasury and these bodies, arising from the need of some measure of financial autonomy for

3. An illustration from Pakistan would serve as an example. In undivided India, the accounts of the nationalised Railway industry was separated from the general budget of the government. After partition, however, the former were amalgamated with the latter in view of the financial difficulties of the new-born state whose survival was put above all other considerations. (see chapter two, p 20 n).

them. A way has therefore to be found out which will assure them the financial autonomy they need, and at the same time make possible the reflection of their financial transactions in the government budget in some form or other.

3. Evolution of the New Idea

We have thus seen that a new attitude towards budgetary structure and classification of government accounts is needed in order that the government may use the budget as an effective and efficient instrument of economic planning. This should provide for (a) economic character classification of the accounts, (b) conformity of budget accounts with national income accounts, and (c) bringing in of the whole of the public sector under the jurisdiction of the budget.

The new attitude practised in different countries:

A brief history of the reactions of budgetary thought and practice to this new attitude in a number of countries may now be attempted. Let us survey the practical field first.

A new role of the government budget was first brought into light after the Great Depression shattered the economies of a number of countries. The first country to adjust its budgetary method to a systematic economic policy was Sweden. The Swedish budgetary reform of 1937 introduced on the one hand the method of balancing the budget over the business cycle, and on the other hand a new system of public accounts parallel to the system of accounts used by a business firm (e.g., profit and loss accounts and the capital account). Though the new

method of cyclical balance ensured that in practice government financial policy would have positively favourable effects on the economy as a whole, the purpose of Swedish budgetary reform was nevertheless not so much the desire to stabilise the economy as to stabilise the value of public assets.⁴ The manipulation of a government budget to serve the best interest of the economy was first seen in the West-- in Great Britain and the United States. It was found ~~found~~ that the budget can, if wisely manipulated, play a significant part in bolstering up a nation's active purchasing power and thereby contribute to the recovery of business cycles and stability of the economy. To facilitate this conscious use of budgetary policy as an 'anti-inflationary' measure, various governments have made attempts to prepare what may be called 'nation's economic budgets'. These are estimates of the national income for a coming year,--estimates where the government transactions also find a respectable place in a way as to fit into the structure of the national income accounts (e.g., after cancelling out transfer payments between the government and the public). These estimates made it possible for the government to visualise the effects of its transactions on the national income, and prepare their budget estimates and plans with an eye to those effects. The White Papers on National Income issued in Great Britain by the government since 1941, and the inclusion of the Nation's Economic Budget in the

4. See chapter four for a critique of the concept of 'financial soundness' that guided this desire.

President's Budget Messages in the United States since January,⁵ 1944, are important examples. In recent years, National Economic Budgets have also been formulated in the Netherlands, Norway and France. The annexed budgets for public undertakings in the budget structure of the government of Italy are also a recognition of the modern idea that the whole public sector should be reflected in the government budget in some form or other.

Theoretical evolution of the idea:

Still more interesting are the theoretical writings and discussions by prominent economists and experts on the way budgetary presentation has to be reformed so as to facilitate this new economic role of the budget. The first serious attempt to lay down the principles of modern budgeting was done by Prof. J.R. Hicks. In 1948 he wrote a small book on the problems of budgetary reform in Great Britain.⁶ The work was inspired by some serious comments and criticisms as regards the presentation of the 1948 budget of the government of U.K. "For the budget year 1947-48, the public accounts(classified in the manner which had become habitual) showed unprecedented surplus of £ 636 millions; but this surplus was not available for redemption of debt, being in fact offset by payments, almost exactly equal in amount, which were placed(with parliamentary

5. Readings in Fiscal Policy--article by G. Colm(The Government Budget and the Nation's Economic Budget)--p 389.

6. The Problem of Budgetary Reform--J.R. Hicks--1948.

sanction) 'below the line'⁷, so that they did not have to be included in the budget account proper.⁸ The work of Hicks contained some illuminating and original contributions on such problems as the budgetary procedure and Treasury control, and budget accounting and accounts of the national income. This, in its turn, stimulated similar discussions and works in various other quarters. Particularly notable among them, and those which directly concern the budgetary problems in the economically underdeveloped countries, are those carried out by different agencies under the United Nations, such as the Fiscal Division of the Department of Economic Affairs and the ECAFE Secretariat.⁹ The studies of these bodies have not been restricted to the theoretical field only; in 1950 the ECAFE Secretariat attempted a reclassification of a few years' budgets of four countries (Burma, Phillipines, Hong Kong and India) according to economic characters of the items of transactions.¹⁰

7. In British budgeting there is nothing like a capital budget as presented in Pakistan and some other countries; however, certain items like 'receipts applicable to debt redemption' and 'payment for which the Treasury has power to borrow' appear in a separate account termed as 'below the line account'.

8. Ibid--p6.

9. e.g.; Budgetary Structure and Classification of Government Accounts; 1951, and 'Government Accounting and Budget Execution', 1952, both published by the United Nations.

10. These reclassified budgets were presented at the seventh session of the Economic Commission for Asia and the Far East held at Lahore in February, 1951. Among these, the reclassified budgets of India were prepared by Mrs. U.K. Hicks.

The latest discussions on this problem was made in September, 1953 in Mexico City, under the auspices of the Technical Assistance Administration, the Economic Commission for Latin America and the Fiscal Division of the Department of Economic Affairs of the United Nations. The purpose of this discussion was "to consider new methods of budgetary presentation and management required for the formulation and implementation of fiscal policies for balanced and non-inflationary economic development".¹¹

4. Economic Budgeting for Pakistan

The need

From the brief history given above, it does appear that by now new ideas on budgetary presentation are already well in the air. These new ideas, we have seen, concern what may be called 'economic budgeting' for the government sector or for the economy as a whole. The task of this paper is to reconcile these ideas with the budget system of the government of Pakistan. Further arguments are hardly needed, to emphasize the need for economic budgeting for the government finances in Pakistan, than those we have already discussed above with reference to the economically underdeveloped countries in general. The government of Pakistan has already accepted its inevitable role in the development of the economy. On the one hand, it is trying to encourage private initiative and enterprise by various methods. It is trying to design its tax-structure in such a way as to

11. 'Budget Management'--Report of the Workshop on Problems of Budgetary Classification and Management, United Nations, p1.

encourage private capitalists in entering the field of industrial enterprise; it has also set up public corporations for the specific purpose of helping private enterprise with means of finance. On the other hand, it has felt the dire need of direct state contribution to capital formation and accordingly entered the field itself; government contribution to capital formation is being made directly through departments connected with the Civil Administration as well as through the Pakistan Industrial Development Corporation. Several funds have also been created to finance government developmental programmes.

In view of these facts, and in the light of what we have discussed so far about the way a government budget, consciously prepared for the purpose, is indispensable for economic planning for the development of an underdeveloped economy, economic budgeting for the finances of the public fisc seems indeed a necessity.

The dearth of attention:

So far, however, sufficient attention has not been paid to this aspect of government budgeting in this country. Attempts have been made by the government to arrive at estimates of the national income of the country in order to provide a guide for planning, and in these attempts the net product of the government sector has been estimated from figures available in the government budgets; but these ^{budgets} ~~as~~ such are not presented in a manner as to render direct help in these estimates. Furthermore, as the

12. 'National Income Estimation in Pakistan', in the Statistical Bulletin (Feb., 1955) published by the Central Statistical Office, govt. of Pakistan.

13. See chapter two--p 36.

government budgets leave out the transactions of the government, sponsored corporations which function as autonomous bodies, the national income estimates tend to underrate the contribution of the government sector to the national income. This also reduces the efficacy of planning through the 'government sector' from possibilities if these autonomous public bodies were also referred to in the national income estimates as falling under the 'government sector'.

These comments, however, are not intended to be outright criticisms. Pakistan is hardly ten years old as a state. The first few years of a new-born state must be busy in stabilising the economic and political conditions of the country. The time for taking a long-run view for the country and moulding its institutions accordingly cannot but come at a somewhat later stage. However, now that the initial financial difficulties caused by partition may be said to have been over, and that the government has already started launching programmes of long-term economic development, the time seems ripe for some reforms in the budgetary structure and presentation of government accounts. The government budget in Pakistan should conform with the modern ideas on budget systems in the light of the role of a budget as a guide in planning for the development of an economy.

A discussion of the budget system of Pakistan, and the reforms necessary in the light of the above discussions, therefore, should be a welcome proposition.

CHAPTER II

THE BUDGET SYSTEM OF PAKISTAN (a critical study)

Order of the study:

In this chapter, the budgetary structure of the central government of Pakistan will be studied in the light of our discussion in the last chapter, i.e., those aspects of the budget system will be taken up for consideration which are relevant from the point of view of the budget's usefulness in economic analysis and planning for the country. The order of the study will be as follows:-

- (1) Public Undertakings;
- (2) Segregation of current and capital transactions;
- (3) Treatment of funds;
- (4) Classification procedures;
- (5) Method of accounting.

The budget documents of the government do not provide any explanation of the budget system in so many words. The description that follows here is based principally on actual examination of the budgets and the supplementary statistical documents, such as the Explanatory Memorandums and the Demands for Grants, as are issued by the government.

1. Public Undertakings

The relations between the public undertakings and the government budget is typical for each country and present an interesting study.

Two types of public undertakings:

In Pakistan there are two types of public undertakings:

(1) those wholly owned by the state and forming an integral part of the central government structure, being operated under the direct supervision of the various ministries;

(2) the government-sponsored corporations, owned partly (having, however, majority share)¹ or wholly by the government, but separated from the central government structure; these corporations are operated by separate bodies (e.g., a Board of Directors). Complete control over their affairs by the government, however, is ensured by the direct appointment of all or most of the directors by the government.

The second category of public undertakings have originated² after the birth of the state of Pakistan. Among them, the State Bank of Pakistan is intended to serve as a general guardian of the monetary system. The other public undertakings have been established to meet the need of government aid and participation in economic development of the country.

Relations with the budget:

The transactions of the second category of public undertakings are not subject to direct budgetary control as the public undertakings of the first category are. Except the State

1. The National Bank of Pakistan, in which the government has 25% share, is excluded from the category of public undertakings; the relations of the government with this bank may be taken as those of the holder of a large share.

2. These public undertakings are: 1. The State Bank of Pakistan; 2. Pakistan Industrial Development Corporation; 3. Pakistan Industrial Finance Corporation; 4. Agricultural Development Finance Corporation; 5. House Building Finance Corporation; 6. Pakistan Insurance Corporation; 7. Pakistan Refugee Rehabilitation Finance Corporation.

Bank of Pakistan, the net profits of which accrue to the government treasury, the finances of these undertakings are completely separated from the government budget. This separation has apparently been made in order to offer them the freedom, autonomy and flexibility of control they require as commercial ventures.

Public undertakings of the first category, i.e., those which form an integral part of the central government structure, are the following:³

(1) Railways; (2) Posts and Telegraphs; (3) Irrigation; (4) Salt; and (5) State Trading.

The finances of these undertakings are, like those of the administrative departments, completely amalgamated with the general government budget. Except in the case of Railways, Pakistan has inherited this tradition from India. The Indian convention, since 1924-25, has been to separate from the general budget the finances of the Railways; the latter are presented in a separate budget introduced by the Minister of Railways a few weeks before the introduction of the general budget. But immediately after partition, the government of Pakistan amalgamated⁴ the whole of the Railway finances with the general budget.

3. There are other department (e.g. Stationary and Printing) which may also be regarded as performing functions of the nature of an enterprise. In the list given here only those, apart from State Trading, have been included which are referred to in the Explanatory Memorandums as commercial departments, and are required to pay interest against the capital assets entrusted with them. A clear-cut sorting out of the public undertakings is not possible unless a more precise and workable definition is given to the term. Such a definition will be attempted in chapter three.

4. "It has been decided that in the circumstances prevailing in Pakistan at present, it will be an unnecessary refinement to have

The operating(current) transactions of the Railways, Posts and Telegraphs and Irrigation are allowed to affect the current budget totals only on a net basis. This net figure is arrived at by deducting, from the gross receipts for the year in question, (a) working expenses, (b) provisions for depreciation and similar funds, and (c) the interest charges against the capital at their disposal advanced from the treasury. The last item(c) is again shown in the budget under the head 'interest receipts', where interest charges received from other bodies and persons are also shown. In effect, therefore, the current budget totals include gross receipts minus (working expenses plus provisions for funds) from these commercial undertakings of the government.

The transactions of salt, however, are shown in the budget on a gross basis. The receipts side shows the gross receipts in two parts: (a) sale of salt and (b) interest on capital at charge, the former under the head 'salt' and the latter under 'interest receipts' as in the other cases discussed above. The summary budget statement does not show separately the finances relating to the two functions carried out by this department, viz., that of collection of salt duty from private enterprises, and of the manufacture and sale of salt by the government as an enterprise.

The treatment of the transactions of the State Trading operations of the government in its budget is peculiar. All the

either a separate Reserve Fund or to maintain the distinction hitherto made between strategic and commercial lines. In consequence of these decisions, the Railway budget has, like that of P. & T. Dept., been made part of the general budget. This amalgamation will not, however, mean any relaxation in the matter of running the Railway on a strictly commercial basis or in maintaining proper commercial accounts. The Depreciation Fund will continue and provision therefore has been made in the usual rates." (Budget speech of the Finance Minister, 1947-48).

state trading transactions, irrespective of whether they are 'current' or 'capital' transactions in the strict commercial sense, are shown in the capital account of the budget on a net basis. This means that the net results of state trading operations are treated as 'net capital receipts or expenditures', as the case may be.

The capital account of the government budget includes the 'capital outlays' on Railways, Posts and Telegraphs and Irrigation, financed from general capital receipts and receipts from the revenue account for depreciation and other funds, if any. No such fund is provided for Irrigation. All expenditures of the Salt department, whether they are operating expenses or expenditures on salt works, are treated as current expenditures, except expenditures on renewals and replacement of capital; the latter is treated as a capital item.

Implication of amalgamation of finances:

The implication of amalgamation of the finances of the commercial undertakings of the government with the general budget is that the former, like any ordinary administrative department, lose their independent character in respect of finances. On the one hand they come under the supervision of the machinery designed to control the disbursement of government money, and cannot spend beyond the specific amounts for specific purposes as approved by the Parliament. On the other hand, a government commercial

5. Detailed breakdown of these two types of finances are, however, provided in the Explanatory Memorandums and Demands for Grants, from which separation of transactions in respect of the two functions can be obtained.

department cannot claim the operating profits, if any, resulting from its own transactions for its own use. Instead, they are carried over to the central pool (treasury) and merged therein, to be budgeted for the next financial year in accordance with the general interest of the government sector as a whole rather than with the needs of the particular commercial department concerned. Similarly, any deficit is met from the treasury, from funds otherwise available for the general interest, and is therefore in the nature of a subsidy from the general budget.

2. Separation of Current and Capital Transactions

Prevailing ideas:

The budget of the government of Pakistan is divided into two accounts: the current and the capital accounts. There is no indication in the budget documents as to the line of demarcation between these two accounts. This has led to considerable misunderstanding in academic as well as in government quarters as regards the economic nature of the items included in the respective accounts. The misunderstanding, in its turn, has ^{led} ~~has~~ to unwarranted notions about the economic implications of the annual budgetary balances in the current account.

Statements are found in academic quarters which assign meanings to the two accounts according to the commonly held ideas about current and capital transactions of a government, i.e., (a) revenue expenditure is mainly incurred on the day-to-day functioning of the government and are financed out of tax-receipts, and (b) capital expenditures are incurred for the purpose of

increasing capital assets of a lasting character, and are
financed out of borrowings and other receipts of a capital nature.
A closer examination of the nature of the transactions included
in the respective accounts would, however, reveal that the
actual practice does not conform to such 'commonsense views'.
Indeed, it appears that the segregation of the two accounts is
not based on any consistent economic criteria at all.

The true picture: (a) expenditure side:

So far as the expenditures are concerned, it does not
seem that there is any criteria at all--economic or ^{non-}economic--
except possibly the criterion of convenience. The whole issue
seems to be subject wholly to 'ad-hoc' decisions by the executive
in respect of the individual item concerned. This view is
corroborated by the following observations:

First, the capital account shows a number of expenditures
which do not result in increase of assets in any way. For example,
the item 'payment of commuted value of pensions' shown as a capital
expenditure neither results in the acquisition of any capital
asset of a material character, nor is it the payment of some
capitalised value so as to reduce a recurring liability; it is
simply the payment of recurring pensionary and providend fund
liabilities of the government of Pakistan in the United Kingdom,
to be met every year.⁷ Similar comments may be made in respect of

6. See, for example, 'Economics of Pakistan' by Dr. S. M. Akhtar, p 415, and 'Report on Currency and Finance', 1954-55, issued by the Department of Research, State Bank of Pakistan, p 50.

7. The treatment of this expenditure as a capital item has apparently been the result of the U.K.-Pakistan financial

other items shown in the capital budget for any year taken at random--e.g., 'lump sum provision for emigrant expenses' under the head 'capital outlay on ports'. These are not 'investments' in the sense that they do not result in any sort of material asset formation.

Secondly, the current account, in its turn, shows a number of expenditures which result in the creation or acquisition of assets of a lasting character, such as a number of expenditures on 'works', 'purchase of tools and plants' and 'stores'. Four typical examples are given below:-

- (1) As pointed out in section one of this chapter, apart from expenditure on renewals and replacement of capital, all the expenditures of the salt department, whether of a recurring (e.g., pay of officers) or of an asset creating (e.g., outlay on salt works) character, are shown in the revenue account.
- (2) The 'expenditures on Irrigation met from revenue' include expenditures on 'unproductive' works, i.e., works which though result in asset formation, are not remunerative in the commercial sense. The underlying principle seems to be that of 'prudent' (?) finance, once inunciated by the government

agreement of 1948. According to this agreement, a lump sum of about £8 million sterling was funded with H.M.G. in blocked sterling, in return for which Pakistan would receive sterling annuities during the next fifty years to enable pensionary and providend fund liabilities in U.K. to be met from year to year. But in principle an annual liability cannot be regarded as one to be met from accumulations of past reserves. The logical procedure would be to treat the payments of sterling pensions etc. as current expenses met from current revenue (e.g., current receipts in sterling). The resulting deficit, if any, in the current account would of course have to be met from accumulated sterling reserves, resulting, in its turn, in diminishing of sterling balances. Instead of this, the procedure adopted by the government results in 'hiding' of current expenditure in the capital account and as such overstating of the budgetary balance in the current account.

of India in its prepartition days.⁹ According to this principle, the decision as to whether an unproductive expenditure is to be financed from taxes or loans was to rest upon two considerations: (a) urgency of the expenditure--whether or not it can be postponed or distributed over a series of years; and (b) size of the expenditure--whether the amount is 'too great' to be met from revenue.

(3) The defence expenditures met from revenue sometimes include expenditures on defence installations but which are generally charged to the capital account. In the revised estimates for 1950-51, and the budget estimates for the following year, a sum of Rs 10 crores was 'transferred' from capital to revenue as, "in view of the improvement of revenue position", it was "possible to meet this portion of the capital outlay on Defence from within the revenue account".¹⁰

(4) The most striking example is, however, the treatment of expenditure on Civil Works which includes the construction of buildings and communications. These expenditures are shown in part in the current account and in part in the capital account, and the criterion for separation appears to be totally arbitrary. As a result, both the current as well as

8. Demand no. 76, explained in the Demands for Grants, p435.

9. Vide 'The A.B.C. of Indian Government Finance, by P.K. Wattal, 1940--p 20.

10. Explanatory Memorandum on the Budget of the Central Government for 1951-52, under revenue expenditure on Defence.

the capital account show the same type of items, such as 'original works-buildings' etc. The climax is perhaps the decision taken lately by the government that with effect from 1955-56 "all major works costing Rs 1 lakh and above would be charged to the capital account" in respect of civil works, works costing less than Rs 1 lakh being left for the revenue account. That means expenditures on civil works will contribute to a budget surplus or deficit according as there are little or many less-than-one-lakh projects!

These examples serve to make nonsense of all speculations as regards the true economic nature of the line of demarcation between current and capital expenditures of the government. There is no economic line of demarcation at all in fact. Further, in view of the examples (2) and (3) above, one cannot perhaps be blamed for holding the opinion that the budgetary balance is more or less pre-determined before a number of items of expenditure are allocated to the two accounts. The idea that an expenditure may be 'too great' to be met from revenue, and that it may be met from revenue if the revenue position improves, obviously implies that it would upset an otherwise satisfactory budgetary balance if revenue positions do not improve. This, therefore, amounts to 'hiding' the true nature of the budgetary balance from public eyes. The reason may be anything but economic--e.g., they may be political, or may even be the desire to enjoy an artificial feeling of complacency of having 'balanced' the budget.

Receipts side:

The treatment of the line of demarcation on the receipts

side is somewhat more consistent; i.e., the classes of receipts appear in the current and capital accounts respectively every year. No economic basis of separation, however, is observed in this case also. The allocations, moreover, show inconsistency with the commonly held notion that the current account includes mainly tax-revenue, while the capital account shows receipts of a capital nature. For, a few items appear in the current account which from the economic point of view are receipts of a capital nature. For example, receipts from the sale of land is shown under 'Land Revenue' as a current receipt, while in fact it implies a diminution of the states assets in the form of land and ought, therefore, to be offset by showing the corresponding receipts in the capital account.

Conclusion:

One important conclusion emerges from this state of affairs in respect of the separation of the capital account from the current. If there is no consistent economic criterion on which the two accounts are separated, the balances in the respective accounts cannot claim any significance whatsoever except being mere accounting records. If any ad hoc decision can put down some or other item under the current or the capital account, the balance in either account becomes dependent upon such decisions; the government can, by manipulating this dependence, give almost any magnitude to either of the balances as long as it is not altogether revolting. Even if such manipulations are not done consciously, so long as there is any amount of arbitrary allocation

of items between the two accounts, the budgetary surpluses or deficits will fail to possess any meaning which can be taken as a norm and which can be consistently applied in any sort of analysis of the budgets. Only the overall balance, which signifies changes in the cash balance position, can claim some analytical value.

Drastic as it may seem, the above conclusion discredits any attempt to assess the financial 'soundness' or otherwise of the government from a mere review of the budgetary surpluses or deficits. Opinions expressed in government and many other quarters as regards the sound financial position of the central government having been revealed by the series of budgetary surpluses from 1948-49 to 1953-54 do not, therefore, deserve any attention.¹¹

3. Treatment of Funds

Since partition the government of Pakistan has set up a number of funds, generally called 'reserve funds'. The monies entrusted with these funds are meant for specific purposes. Examples of such funds are: the Fund for Rehabilitation of Refugees, for Social Uplift Schemes, for Agricultural Development and so on. The treatment of the transactions of these funds are not uniform in many respects, and are different from the treatment of the transactions of the government departments. The characteristics of the treatment of the transaction of the funds in the budget are given below.

11. Government views are stated quite explicitly. Vide, e.g., 'Economy of Pakistan' (1950), p 270.

All transactions shown as capital items

The first characteristic about the funds is that every transaction of a fund is regarded as a capital item in the budget.¹² The receipts of the funds are recorded in the summary budget statement under two headings: capital receipts of (a) Railways and Post and Telegraph Reserve Funds and (b) other Reserve Funds. The expenditures, on the other hand, are in part absorbed in different 'direct capital outlays' which are partly financed from the funds, and the remaining part recorded under 'expenditure met from Reserve Funds'.

While all the expenditure from the funds are itemized on the capital side, they are not all of them true capital outlays in any economic sense of the term. The item 'expenditure from Reserve Funds' contains a number of expenditures which are shown in the Demands for Grants along with other revenue expenditures, but later deducted as 'amounts met from funds' and transferred¹³ to the capital account under the above head. Part of the 'expenditure from Reserve Funds', therefore, are current outlays though the whole of it is finally put in the capital account.

12. This conclusion has been arrived at from statistical observation: Taking the budget for any year, say the budget estimate for 1955-56, for illustration, the following data support the conclusion:

(1) The total disbursement from the various funds (excluding the Foreign Aid Fund, whose money is not met for any specific purpose) shown in the budget amounts to Rs 25,3828000. This has been calculated by adding up the figures corresponding to the funds, starting from the Railway Depreciation Fund (p 15) to the Posts and Telegraphs Welfare Fund (p 17), and adding to it the figure for the deposit account of Grants for Social Uplift Schemes (Central Areas) which is given separately (bottom of p 17);

(2) The part of the expenditure from the funds which has been amalgamated with capital outlays under departmental heads amounts to Rs 12,0169000 (p 13);

(3) The difference of the above two amounts is Rs 13,3659000; this exactly tallies with the amount shown in the capital account as 'expenditure from Reserve Funds' (p 5).

This all the more confirms our conclusion arrived at in the last section of this chapter that the budgetary surpluses or deficits shown by the government are nothing more than mere accounting records, and as such are of no help in assessing the financial position of the government or its budgetary policy.

Treatment of receipts:

The funds receive their money by transfers of amounts from the revenue account of the budget to the fund concerned in the capital account. There are three different ways of transferring these amounts as practised by the government in the case of different funds. These three ways are:-

- I. Transfers of a fixed earmarked portion of a particular duty or tax to a particular fund(e.g., the Central Road Fund);
- II. Ad hoc transfers of lump sums, not fixed in amount or proportion annually(e.g., Fund for Closer Inter-Provincial Contacts); in both these cases transfers are regarded as current expenditure under the specific heads of the administrative or functional units(e.g., the Cabinet Secretariat in case of the Fund for Closer Inter-Provincial Contacts) through which the money is transferred or to which the administration of the fund may be attached;
- III. Ad hoc transfers of lump sums from revenue surpluses (e.g., the creation of the Social Uplift Fund from part of the revenue surplus in the 1950-51 revised estimates).

13.e.g., the establishment and other charges in connection of the Food Emergency Committee under the Ministry of Food and Agriculture(Demands for Grants for 1955-56, p 135-136).

Treatment of expenditures:

The expenditure of the monies entrusted with the funds is effected in either of the two ways:-

- I. By transferring the required money to the general revenue back, from which it is allocated to the specific departments under which the money is to be spent. This procedure is followed in the case of the Social Uplift Fund, from which monies are transferred annually to the Departments of Education, Health etc;
- II. By spending the money directly from the fund under the care of the department concerned, without transferring it to the latter. This is found in case of a number of funds like that for Agricultural Development and others.

In a number of cases, however, no mention is found anywhere in the budget documents as to the nature of disbursement of money from particular funds. For example, the budget estimates for 1955-56 shows disbursement of Rs 3.5 crores from the Fund for Rehabilitation of Refugees¹⁴, while explanation of only Rs 0.7729 crores are found¹⁵ in the Demands for Grants; the remaining portion of Rs 3.5 crores remain unexplained. Similar observations may be made in respect of other funds like the Fund for Agricultural Development.

Overstatement of budget totals:

In final criticism of the treatment of fund transactions, the double counting, in arriving at the budget totals, of the sums involved in transfers between the revenue account and the funds (capital account of the budget) is to be noted. Whether an amount

14. Budget of the Central Government of Pakistan for 1955-56, p 7.

15. Demands for Grants, for 1955-56, p 445.

is transferred from a department account or from the overall revenue surpluses, to a particular fund, no deduction is made of the amount in arriving at the budget totals. This results in undue inflation of the budget totals (current plus capital) on both the receipts and the expenditure sides. In cases where money is transferred back to the revenue account (e.g., the Social Uplift Fund), and no corresponding deduction is made from the budget totals, the inflation takes a third magnitude. This obscures the true magnitude of the transactions of the government sector vis-à-vis the rest of the economy.

4. Classification Procedures

Apart from the broad classification of the items into revenue or capital ones, the budgets of the government of Pakistan show the following classifications in its statements of the revenues and expenditures:

Revenue account:

- I. The transactions of the Revenue Collecting Departments are classed together under the heads 'Principal Heads of Revenue' and 'Direct demands on Revenue' for receipts and expenditures respectively.
- II. The transactions of the departments in charge of Civil Administration are shown under the head 'Civil Administration'.
- III. Among the other items, the transactions of Railways, Posts and Telegraphs, and the operations in connection of

Irrigation, Debt Services, Currency and Mint, Civil Works and Defence Services are placed under separate individual heads.

- IV. There are two other heads, viz., (1) 'Miscellaneous', consisting of (a) Superannuation items, (b) Stationary and Printing, and (c) items classed as miscellaneous, and (2) 'Extraordinary items', consisting of Civil Defence transactions and other items classed as extraordinary.
- V. Apart from these, the expenditure side shows separately the 'Contributions and miscellaneous adjustments between the central and provincial governments'.

Capital account--receipts:

- I. Net permanent debts of the government, internal and external shown separately under individual heads.
- II. Treasury bills and other floating debts(net).
- III. Net unfunded debts, like savings bank deposits etc.
- IV. Receipts in the Railway and Post and Telegraph Reserve Funds(which represent transfers from the revenue account).
- V. Receipts in other reserve funds like Social Uplift Fund etc.
- VI. Foreign aid fund, showing the values of foreign grants and assistances in Pakistan currency.
- VII. Recoveries of loans and advances.
- VIII. The net surplus, if any, from state trading operations.
- IX. Miscellaneous capital receipts, consisting of annuity receipts for sterling pensions from U.K., and other receipts of a 'capital nature'.

- X. A separate category of receipts in Deposits and Remittance transactions(net), covering the net receipts in various deposit accounts like Civil Deposits, and net receipts in all adjusting heads such as cash remittances from one treasury office to another, transfers between different accounting circles and remittances between Pakistan and U.K;

Expenditures:

- I. Direct capital outlays, under which are shown those expenditures which are met neither from revenue nor from funds; the items are subclassified according to the department or line of government activity concerned, e.g., 'Railway capital outlay' or 'capital outlay on fuel and power projects.'
- II. Expenditure from reserve funds, discussed in the last section of this chapter.
- III. Development loans to provinces, states, local bodies etc.
- IV. Other loans and advances--to government servants, cultivators etc.
- V. Net deficit, if any, incurred in state trading operations.

From the above account of the classification procedures it must be clear that the government budget in Pakistan follows a pattern of what we have called 'administrative' classification in the first chapter. The expenditures are classified according to the administrative function or line of government activity, and more or less parallel classification is maintained

16.however, some of these capital outlays are financed partly out of funds(see p 30n).

for receipts. Alternatively, this system of classification has been termed as 'functional' in literatures on modern budgeting. Such classification on functional basis is undoubtedly useful and perhaps essential¹⁷ for the executive for the effective functional of the administration. But it conceals the economic characters of the transactions, and includes transactions with different economic characters under the same heading. 'Administrative' or 'functional' classification is, therefore, unsuitable for economic analysis, and in Pakistan 'economic character classification' has not yet come in vogue.

Classification and national accounting:

One more aspect of the Pak budgetary classification remains to be mentioned, viz., its relation with national income accounting. From the above discussion of the classification system, it must be evident that the budgets do not mark out those transactions which are significant for purposes of social accounting or national income calculation. For example, the budgets do not identify the 'transfer payments' as distinct from 'economic payments' (government purchases of goods and services), or show the total expenditures in domestic and foreign currencies respectively under separate heads¹⁸. Furthermore, as

17. The unsuitability of the alternative, viz., the economic character classification', for administrative purposes is discussed in a separate chapter (chapter six).

18. The Demands for Grants, which shows a detailed breakdown of the totals shown in the main budget statement, shows one classification which at first sight seems to approach the target, viz., 'charges in England'. These are payments in sterling, the accounts for which are maintained in London. But these do not cover the total payments in foreign currency. Besides charges in

mentioned earlier, not all the expenditures shown in the revenue account represent actual payments to the public; some are transfers to various funds, which amounts to 'transfers to itself' if the government sector is viewed vis-a-vis the rest of the economy; unless these transfers are deducted from the totals, the national income accounts are liable to overstatements.

It may be mentioned that it is not Pakistan alone which shows this failure of budget accounts to show conformity with national income accounts. It seems to be the inevitable result of traditional budgeting, because of its exclusive concern for the proper administration of government money, in almost all countries where it is still followed.¹⁹

5. Method of Accounting

Gross basis of entries:

We have already seen that transactions are recorded on a net basis for the Railways, Posts and Telegraphs, Irrigation and State Trading. That amounts to the practice that working expenses are first met from the receipts of the department concerned before handing over money to the treasury. Apart from these four cases, all transactions are entered in the budget on a gross basis. That is, receipts realized by a department are credited to the treasury as revenue and not specifically used for meeting its expenses.

England, there are other expenditures which are obviously made in foreign currency (e.g., contributions to international organisations like F.A.O., W.H.O. etc. under 'Foreign Affairs') though they may not represent purchase of goods and services from England and as such do not come under 'charges in England'; these expenditures are amalgamated, in the budget, along with expenditures other than charges in England.

19. For example, in Great Britain, where the "failure of the budget

In cases where revenue receipts are refunded later, the refund is shown as a deduction from revenue, thus avoiding double counting which would result if the gross revenue receipts were shown on the revenue side and refunds shown on the expenditure side. This is probably the only instance where overstatement is avoided.

Cash basis of accounting:

The budget accounts of the government of Pakistan are kept on a cash basis, i.e., they are records of the actual cash transactions for the financial year in question, irrespective of the fact that (a) the receipt or expenditure may be in respect of previous years, or (b) the government may have incurred liabilities or acquired rights to money that do not materialise in actual cash transaction during the financial year in question. For example, an income tax may not be realized in the same year it is assessed, so that rights accrued do not equal cash receipts.

A detailed discussion of the relative advantages and disadvantages of the cash system of accounting as against its alternative, the 'accrual' system (showing rights accrued and liabilities incurred) will be taken up in the next chapter. For the time being it may be noted, in anticipation of the conclusions in the said discussion, that while the cash basis is sufficiently satisfactory for the departments carrying out administrative operations, it is not so in the case of the commercial undertakings of the government; the cash basis does

accounts to come in connexion with the account of the National Income White Paper has become glaringly obvious" (Hicks--The Problem of Budgetary Reform, p 54).

not make it possible to visualize the true profit or loss position, that result from the current operations of the undertakings, from a glance at the budget.

Valuation of real assets:

Finally, except in the case of the Railways, Posts and Telegraphs, Salt and Government Presses, no attempt is made to arrive at an objective valuation of stocks and other real assets (as distinguished from financial assets like shares) or provision for regular depreciation of such assets. Depreciation and other funds in case of the Railways and the Government Presses and Renewals Reserve funds in case of Salt and Posts and Telegraphs only are provided out of the revenue account every year. This is not a criticism; for the practical feasibility of objective valuation and maintenance of non-revenue-producing real assets in countries with imperfect accounting skill is open to question. However, for stocks the feasibility is beyond question, and the absence of any figures for stock-taking for the state-trading operations in particular makes it impossible to arrive at any idea of the real profit or loss resulting from these operations during the financial year in question.

Summary of Conclusions

Our findings in this chapter are important; for they throw light on the deficiencies of the present budgetary structure of the government of Pakistan as a guide to economic analysis and planning. It will, therefore, be helpful if we recollect the

20. See chapter three, section 2 for a discussion on this point.

main conclusions:-

- I. The budget does not reflect the transactions of the public undertakings set up after partition; the finances of the earlier ones are completely amalgamated with the general budget.
- II. The line of demarcation between the current and capital accounts is arbitrary; consequently, the budgetary surplus or deficit has no analytical significance.
- III. All the transactions of the funds, irrespective of their respective natures, are treated as capital items; the treatment of transfers of monies between general revenue and funds result in overstatement of budget totals.
- IV. The classification procedure is $\neq$ of the traditional 'administrative' (or 'functional') type; this does not show the economic characters of the transactions; nor do they assist in national income accounting.
- V. The accounting is on a cash basis; there is no attempt to arrive at an objective valuation of 'non-commercial' real assets, and no statements as regards changes in inventories in case of the trading operations.

CHAPTER III

THE PROBLEM OF COMPREHENSIVENESS

" 'Ad hoc' exclusion of particular state activities is a notorious danger to good budgeting; if the budget only covers a part of the state's responsibilities it is bound to deteriorate in effectiveness as an instrument of policy."-- J.R. Hicks.

Introduction:

In chapter one we saw that an economic budget should provide for three things: (a) economic character classification of the accounts, (b) conformity of budget accounts with national income accounts, and (c) bringing in of the whole of the public sector within the framework of the budget, or what may be called 'comprehensiveness in budgeting'. In chapter two we satisfied ourselves that none of these are provided for in the traditional form of budgeting as practised by the government of Pakistan. The task of this and the following two chapters will be to study the possible framework and the problems thereof for an economic budget for the government of Pakistan.

In the present chapter we shall be concerned with the third requisite for an economic budget, namely, the problem of comprehensiveness. Logically, this deserves prior attention before the two other requisites, for it is only when we are sure of the scope of the budget ~~that~~ we can talk about the classification of the items that fall within the said scope.

1. The four economic functions of the government and their relations with the budget

Comprehensiveness in budgeting consists of giving a complete picture of all the economic functions of the government, or the

government sector of the economy. The scope of the government sector is best understood by distinguishing between the four broad categories of government functions in the economy, as laid down in the 'Budget Management'¹:-

- " a) Government as a collective consumer of part of the national product; that is to say government as provider of common services such as defence, maintenance of internal security and justice, public health and education, financed by taxation and borrowing.
- b) Government as a redistributor of income through the provision of money transfer payments, either directly out of general revenue funds or, indirectly by means of compulsory social security schemes.
- c) Government as an entrepreneur, characterised by its trading and production activities undertaken in the public interest....
- d) Government as promoter of long-run development of the economy and stabiliser of the level of output and employment...."

Out of these four functions, the last one overlaps with the first three. For the government attempts to promote long-run development of the economy either by entering the field of industrial or developmental activities itself, thus in effect functioning as an entrepreneur(c); or the government does so by various measures such as tax concessions and subsidies inducive to private enterprise, and these measures come under the functions (a) and (b). Indeed, "the promotion of economic stability and development.....is more in the nature of a general objective² towards which all government functions may be directed."

For our purpose, therefore, we are virtually left with three functions of the government in the economy. Out of these,

1. p 5.

2. Ibid, p 5-6.

the first, namely, the government as a collective consumer of part of the national product, is already under the scope of the existing budget structure; after our discussion in chapter two it can perhaps be said without any fear of contradiction that the reflection of the financial transactions relating to this function of the government is the main purpose for which 'traditional' budgeting exists.

The second function, namely, the government as a redistributor of income, is also included in the budget. In Pakistan there is no elaborate social insurance system. All the transfer payments consist only of superannuation allowances and pensions and grants of monies to individuals, institutions etc. These redistributive transactions are integrated completely into the general budget along with other transactions, and are administered by the same departments as administer the latter. In the absence of any elaborate social insurance system, separate treatment of the few social security payments like pensions etc. does not appear to be an economic proposition.

It is the third function, namely, the government as an entrepreneur, that is not fully covered by the existing budget structure of Pakistan. As we have seen in the last chapter, the budget does not reflect the transactions of the public undertakings set up after the partition. But in the interest of the effectiveness of the budget as an instrument of policy, it is desirable that all public undertakings should be brought within the framework of the budget.

2. Public Undertakings--the need for separate accounting

We have now to face one serious question, Granted that all the newly started public undertakings in Pakistan, like the State Bank, the P.I.D.C. and others, have to be brought within the framework of the budget, does this imply that they are subject to the same type of budgetary control and accounting as the ordinary administrative departments are subject to ? If so, then there are reasons for strong objections. These reasons arise from the typical character of enterprises,---as distinct from ordinary administrative departments,---that requires the separation of the transactions of the public undertakings from those of other departments of the government. Such separation is necessary from the following considerations:-

Separation from accounting considerations:

First, separation is needed from the accounting point of view inasmuch as the public undertakings require a different accounting pattern from that followed in respect of the administrative departments of the government. The accounts of the latter are usually kept on the cash basis in most countries (except possibly a few continental countries like France and Italy); this, as we shall see, do not result in any serious distortion. On the other hand, cash accounting is typically unsuitable for departments and undertakings run along 'commercial lines'. The main implication of running a concern along commercial lines is that the concern is supposed to compare its annual returns with annual costs; the balance--either a profit or a loss-- is to serve as a valuable

guide to the price-output policy and similar other considerations. This is as true for a purely commercial private concern whose main interest is to go in for profits, as for a government commercial undertaking where the 'service motive' sometimes overshadows the profit motive. In the latter case, though an annual loss need not necessarily dictate a policy of raising prices, say, it will still serve as an important guide to the efficiency of managing the concern as compared with that of similar private concerns within the country and with similar public concerns in other countries, and will also have to be taken into account in policies of subsidizing undertakings running at a loss.

If it is thus agreed that whether or not a commercial undertaking is owned privately or by the government, its annual profit or loss position has to be correctly ascertained, the cash basis of accounting must be rejected as unsuitable for it. Three broad arguments may be put forward:

(a) The question of uncollected earnings and unpaid commitments:

As we saw in chapter two, the cash basis of accounting does not record earnings which are not collected during the financial year in question, and expenditures which have been committed, but not actually paid in cash during the year. On the other hand, it records cash receipts and cash expenditures which are respectively assessed and committed in some previous year, but which are actually received or paid in cash during the year in question. The main advantage of this system of accounting is that it makes possible prompt closing of accounts after the end of the financial

year. If the accounts for a particular year are to show all the rights accrued and liabilities incurred during that year irrespective of when the actual cash transactions take place, it remains still uncertain, when the financial year ends, as to what the realized totals of expenditure and receipts which are considered to belong to that year will be, and the accounts for the year have to be kept open long after the year is over. An interesting and convincing instance from the French government accounts was cited by P.K. Wattal: "the French accounts for 1920 were finally closed only in the beginning of 1937, whereas the Indian accounts³ of a year are closed by the end of October of the following year."

As against this advantage, the disadvantage of the cash system is that it does not present at any time the true 'state of affairs', or the profit or loss position where such state of affairs is relevant. For a profit that is calculated for a particular year without taking into account, say, the unpaid commitments relating to that year cannot be the 'true' profit; it will result in overstatement of the profit for the year in question, and corresponding understatement for the year in which the deferred payment is made. Deferred payment is a debt, and similarly deferred earning is a credit; credits and debts incurred during a year must be taken into account before the true profit or loss position for that year can be correctly ascertained.

It is, therefore, obvious that the cash basis of accounting is unsuitable for the public undertakings run along commercial lines, to which the profit and loss position is

3. 'The A.B.C of Indian Government Finance'--Wattal, p 15.

typically relevant. For the administrative departments, the profit and loss position, however, is entirely irrelevant; moreover, the prompt closing of accounts under the cash system is undoubtedly an important advantage from the administrative point of view. While for a commercial undertaking this advantage has to be sacrificed in favour of assessing the true state of affairs at any instant of time, there is no reason why it should be so sacrificed in the case of an administrative department. The only disadvantage of having a cash system for these departments appears to be this: the financial results (e.g., the budgetary surpluses or deficits) of the budget under such a system depend to a large extent upon the speed of realizing revenues and making payments by the government departments; for example, it makes possible for the government to produce, within limits, any financial result it pleases for the year in question simply by slowing down or accelerating the process of realization or payment of money (e.g., by slowing down or accelerating the issue of income tax assessments). It must be admitted that under such circumstances the financial results of the budget lose much of their significance. However, it seems to be an unnecessary caution to attach too much weight on this possibility. For in trying to balance an otherwise unbalanced budget by such means as speeding up the realization of revenue, the problem of a larger unbalance in the next financial year must necessarily be faced. And to this problem the government cannot remain indifferent. For this reason, generally speaking, the carry-over of such items as unpaid taxes from year to year is more likely to be proportional to the amount collectable than

show 'lumpy' increments or decrements.

(b) The need for stock accounting for trading concerns:

The second argument for separation of finances relates to those public undertakings that are concerned with the purchase and sale of goods,--for example, the state trading concerns of the Pakistan government. These concerns must necessarily take into account the value of opening or closing stocks in order to arrive at the true profit or loss position for any financial period. Statement of the simple cash transactions cannot give any indication of the true state of affairs if part of the cash receipts accrue from sale of stocks accumulated during previous periods, or if some goods remain unsold during the period in question.

(c) The need for depreciation accounting to maintain capital intact:

The third argument relates to those undertakings which are entrusted with some capital assets which they are required to preserve intact(e.g., the Railways). In this case, proper depreciation accounting is indispensable in order that profits and losses are stated correctly. For "as the wasting of an asset contributed to the earning of profits, it is only right that it should be viewed as an expense; and in order to arrive at the profits of an undertaking, it is imperative that the question of depreciation should be considered, as no true profit can be ascertained until all losses or expenses incurred for the purpose of earning an income are charged against such income."⁴

4. 'Advanced accounting', J.R. Batliboi--p 608.

From the above three accounting considerations, separation of the finances of the public undertakings from those of the administrative departments seems to be imperative. While the cash basis of accounting suits the latter, the former require what is known as the 'accrual basis' of accounting, which recognises the need for recording rights accrued and liabilities incurred, that for stock taking, and for depreciation accounting.

Separation necessary even on the budget level:

Although the government of Pakistan do not show the finances of the two types of government activities,--viz., the administrative and the enterprise types,--separately in its annual budgets, it is understood that proper commercial accounts, in addition to and outside the regular cash accounts, are maintained for each public undertaking on a department level. These commercial accounts are, however, not given any publicity. But modern budgeting requires that the separation should be made on the budget level as well. Three main reasons may be put forward:

(a) First, if the budget is to serve as a guide to economic policy, the true profit or loss position of the public undertakings must be shown in the budget, for these must be taken into account in formulating price and subsidizing policies for the public undertakings.

(b) In a democratic country, where government decisions are ultimately influenced by the tax-payers through the legislature, it is essential, in the words of Mrs. Hicks, "for the tax-payer to know the extent of the profit or deficit for each type of trading" activity of the government; "a full profit and loss

account must therefore be available and should be completely segregated....from the non-trading activities of the department concerned."⁵

(c) Finally, the publicity of the statement of affairs of the public undertakings is necessary not only in the interests of the tax-payers, but also in the interests of the private entrepreneurs. This necessity arises from the uncertainty created in the commodity market by the transactions of the government transactions. As the latter are not always guided by the profit-motive alone, ~~so~~ the prevailing ideas of general business reactions to price-changes do not apply to the public undertakings without qualification. The transactions of the public undertakings, therefore, are uncertain even to speculators who 'rationalize' uncertainties by applying the laws of probability^{bi}. The problem is all the more aggravated because of the large scale of government operations. It is therefore necessary that the 'story' of government transactions should eventually be made available in detail, so as to make it possible for private traders to "accustom themselves to the effect of government intervention, and by making proper allowance for it, contribute to that steadiness in prices which is the main justification of the intervention."⁶

Separation on management considerations:

Independent accounting for public undertakings is demanded not only from accounting considerations, but also from considerations of management. The latter demand arises from the

5. Public Finance--Mrs U.K. Hicks--p 379.

6. Ibid, p 380.

need for greater flexibility for the management of public undertakings than is provided in the system of detailed control designed for the operations of the administrative departments. We have discussed this system of control in chapter one. The essence of this is to ensure that money is exactly spent on the purposes for and in the ways as it has been appropriated in the budget. But this type of minute control is absurd for concerns whose spending policy must essentially depend upon the day-to-day fluctuations of market prices of goods in which they have to deal. It is not, therefore, possible to direct the detailed use of money for such concerns from a ministerial level through the budget. These decisions should be left to those who are directly connected with the activities of the concerns rather than to the members of the legislature who are not directly in the field.

3. The Dilemma and the Compromise

It is probably for these reasons that "there has been the tendency to push some of the government's trading responsibilities [in particular the nationalized industries] outside the budget altogether"⁷ in countries like Great Britain⁸ and, as we have seen, in Pakistan as well. But this places too much weight, rather, on the needs for separation. Complete segregation from the budget of the transactions of public undertakings raises the other problem of reducing the effectiveness of the budget as an instrument of economic planning. We are therefore faced with a dilemma for which a compromise has to be found out. The compromise

should on the one hand recognise the need for independent accounting for the public undertakings, and on the other hand bring the transactions of these undertakings within the framework of the budget in some form or other so as to permit a picture of the government sector as a whole from a look at the budget.

The General Government Account and the Enterprise Account:

The need for such a compromise has been recognised in all discussions on modern budgeting, and a simple devise has been found out to meet it. It has been suggested that different types of accounts be set up for these different types of government activities. This amounts to keeping two separate accounts in the budget: the first showing the activities of the government as a provider of common services(function 'a') and of money transfer payments(function 'b'), and the second showing the activities of the government as an entrepreneur(function 'c'). The first may be called the GENERAL GOVERNMENT ACCOUNT, while the latter the ENTERPRISE ACCOUNT.

7. 'The Problem of Budgetary Reform'--p13.

8. "The underlying reason for the creation of the modern type of public corporation is the need for a high degree of freedom, boldness and enterprise in the management of undertakings of an industrial or commercial character and the desire to escape from the caution and circumspection which is considered typical of government departments". ('The Public Corporation in Britain' by W.A. Robson, in 'Problems of Nationalized Industry'--p 16)

9. See 'Budgetary Structure and Classification of Government Accounts, p 8; 'The Problem of Budgetary Reform', p 27; 'Budget Management, p 6.

The general government account should, as we have already¹⁰ discussed, retain the cash basis of accounting. The enterprise account, on the other hand, should be recorded on strictly commercial methods, taking into account changes in stocks, depreciation of capital, and the accrual basis of recording¹¹ transactions.

Once two separate accounts are kept, according to the above principles,--the one on a cash basis and the other on the model of commercial accounting,--the first need of public undertakings, viz., separation of their accounts from those of other government departments, is satisfied. There, however, remains the second need, viz., that for greater flexibility than is provided in the system of detailed control designed for the operations of the administrative departments. This, however, provides no difficulty once separation is obtained on the accounting level. A simple act of legislature, requiring that the enterprise account will not be subject to the same pattern of budgetary control as is exercised over the general government account for the administrative departments, should be enough. What particular pattern of control is to be exercised over the enterprise account is a matter to be decided upon by the legislature. It is quite conceivable that the legislature may find it appropriate to exercise different types of control over the accounts of different

10. p 47.

11. The enterprise account may consist of trading and profit and loss accounts for the trading bodies and income and expenditure accounts for non-trading bodies as counterparts of the current general government account, and capital accounts showing capital receipts and expenditures as in the general government capital account.

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types of public undertakings.

These principles are not altogether new. The separation of the accounting of public undertakings from that of ordinary administrative departments is found even in some countries where the idea of 'economic budgeting' has not yet been seriously taken up by the government. For example, in Italy a number of public undertakings wholly owned and operated by the government have "separate budgets which are published as annexes to the general budget and are approved by the Parliament at the same time as the latter."¹³ Among countries which have advanced to some degree in implementing the ideas of modern budgeting for economic analysis and planning, separate accounting for public undertakings are found in U.S.A.¹⁴ and Sweden.¹⁵

Interdependence of the two accounts:

It should be noted that the two accounts will not be quite independent of one another. The peculiar nature of financing the various activities of the government in Pakistan will make the enterprise account depend on the transactions recorded in the general government account and vice versa. For example, by legislature the net profits of some government enterprises, like the Railways, Salt etc., are to be amalgamated with tax and other receipts from the administrative departments; these profits are

12. While requiring less rigid control over the transactions of the public undertakings in general, the legislature may decide, in the case of 'fiscal monopolies' like the manufacture and sale of salt, close scrutiny of the operations, since they may affect government decisions in respect of the taxation of salt produced by local private manufactures. This practice is followed in Italy (vide Budgetary structure and classification of Government Accounts, p 56).

13. Ibid, p 55.

14. Ibid, p 84.

15. Government Accounting and Budget Execution, p 70.

to be budgeted in the general interest of the government sector as a whole, and not in the particular interest of the enterprise concerned. In such cases, this net profit has to be shown in the general government account as well, as an 'appropriation to the general revenue' from the public enterprises. Again, the capital expenditure of many government enterprises, like the Railways, are not met from funds directly borrowed from the public, but from interest-bearing advances from the general capital account of the government. In such a case, this amount has to be shown as a capital receipt in the enterprise account.

In any consolidated statement comprising the aggregate transactions of the government sector as a whole, these inter-account transactions must be allowed to cancel out so as to avoid overestimation of the totals.

4. The Line of Demarcation

We have thus found out a device to bring in the newly established government corporations in Pakistan,--which have so long remained outside the scope of the budget,--within the framework of the budget and at the same time providing for their need for independent accounting. Once this device is put into practice the accounts of the newly established corporations are not the only ones that demand inclusion in the 'enterprise account'. The case of those public undertakings which are already within the framework of the traditional budget structure of Pakistan has also to be considered, i.e., they also demand separation from the 'general government account' and inclusion

in the 'enterprise account' since, by definition, the 'enterprise account' offers them a legitimate room.

Definition of Public Undertakings:

It is here that the problem of the 'line of demarcation' crops up, and it becomes necessary to give a workable definition to the term 'public undertaking' so that there remains no confusion as regards the entry of its accounts in the 'enterprise account'. We have so far spoken of public undertakings as carrying out activities of a commercial, industrial or developmental nature. But the separation of the 'enterprise account' from the 'general government account' has been justified not because of the mere nature of the activity of a public undertaking, but because of the particular nature of its accounting needs. It must, therefore, be admitted that if a government activity, inspite of its commercial or enterprise character, does not require the preparation of its accounts on commercial principles, or does not find the same possible for some reason or other, then there is no reason why the finances related to that activity should be shown in the 'enterprise account' rather than in the 'general government account'. Some practical illustrations should make this point clear:

The receipts from the 'administration of justice and jail' by the government of Pakistan contain some receipts which are of a commercial, and not of an administrative, character. These are the receipts from the sale of miscellaneous products produced by the jail convicts. It would be foolish to ask the jail

administrators to keep the accounts relating to these jail manufactures on a strictly commercial basis in order to have an idea as to whether these manufactures are yielding profits or losses. For such assessments would require, among others, the separation of the services of the personnel for this particular activity from those of the general administrative activities of the jail administration, and the payment for the former out of the receipts from the sale of jail manufactures. However, jail manufacturing is not as large an 'industry' as to make it worthwhile to employ managerial personnel exclusively for its own purposes. It is, therefore, only practical to ^{regard} such commercial activities of the government as 'incidental' to its administrative functions. The accounts related to such activities do not, therefore, deserve separate treatment on a commercial basis.

Another type of government activity in Pakistan is that of the Civil Works department, which carries out the construction of public buildings and roads etc. From the economic point of view, these are developmental expenditures. Buildings and roads are real capital assets, and their maintenance, as Hicks has observed, "is a part of the maintenance of social capital."¹⁶ It, therefore, appears that accounts connected with these expenditures should take into account the depreciation of such assets, and as such deserve inclusion in the 'enterprise account'. However, there are two reasons why they should rather remain in the general government account instead. First, many of these capital assets, e.g., the public buildings and roads, for the use of which road 'tolls' are not charged, do not yield a regular flow of revenue over a number of years which the assets of a

commercial enterprise is expected to do. There is, therefore, no point in assessing the profit or loss position of this department for any particular financial year. Second, depreciation accounting for any asset requires an objective valuation of it. In the case of a revenue yielding asset, this presents no difficulty, as such an asset has always a market value which provides a direct guide for the valuation. But such a guide is not available in the case of non-revenue yielding assets like roads; and to arrive at an objective valuation of such assets by other methods must be extremely expensive and time-consuming in a country like Pakistan with imperfect accounting records and lack of sufficient accounting experience. It, therefore, appears that the accounting of the finances of these activities on a commercial model is also not practicable at present for the government.

Thus we find that there are government activities of a commercial or developmental character which nevertheless require accounting on a simple cash basis rather than accounting on a commercial model. All public undertakings, therefore, in the sense in which we have used the term so far, do not fall within the scope of the 'enterprise account'. In order that it may be so, a public undertaking has to be defined as a government body (owned wholly or partly with full control over its activities) for which it is desirable as well as practicable to have a commercial accounting system.

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16. The Problem of Budgetary Reform--p 27.

17. The examination of each individual case, i.e., whether each particular government activity falls within the scope of this definition or not, should rest upon those directly connected with such activities or a body of accounting experts, and is beyond the intended scope of this paper.

The finances of the public undertakings, so defined, have to be reflected in the enterprise account, and those of the rest of the government sector should be left to the general government account or a 'fund account' which we shall discuss in the next chapter in connection with the discussion of current and capital accounts.

Separation on the accounting level only:

Before closing this chapter, it may be pointed out that we have not spoken of separation of public undertakings at the department or ministerial level, though we have discussed reasons for separation at the accounting level. The separation at the department or ministerial level is not a concern of ours. For our purpose, it does not matter whether the same department, such as the Department of Food and Agriculture, carries out an administrative as well as a commercial activity simultaneously or not, so long as the financial transactions relating to these two types of activities are separately presented in the two respective accounts. The term 'public undertaking' should, therefore, be used as an abstract functional entity rather than as a legal institution. In many cases, such as the Railways, the two concepts will, of course, coincide.

CHAPTER IV

CURRENT AND CAPITAL ACCOUNTS

"The budgetary deficit or surplus would have little meaning if the government's accounts were kept in such a way that the construction of a plant or other productive facility would contribute to a budget deficit and the sale of such an asset would contribute to a budget surplus."---U.N.O.

While discussing the budget system of Pakistan, we found that the existing basis for separation between the current and capital accounts does not rest upon any consistent economic criterion. Nonetheless, there are much inconsiderate talks about the 'financial soundness' of the economy as revealed by the series of budgetary surpluses over a number of past years. Such talks merely invite criticisms against so-called capital budgets guilty of 'hiding' deficits which otherwise would have become apparent.

1. The Concept of 'Financial Soundness'

In this chapter we shall make an attempt to find out an economic basis on which the two accounts may be separated in the government budget. We shall first deal with the general government account only. In doing so, let us start with the same notion of 'financial soundness' ^{as} which is commonly related with ¹ budgetary balances in the current account. We shall try to find out some basis of separation between the two accounts which will make the budgetary balance reflect truly the financial soundness of the government.

1. The relation between the concept of financial soundness and the demarcation between the current and capital accounts has been studied in some length because of the tendency in some quarters interesting in modern budgeting to recommend the Swedish practice in this respect for the underdeveloped countries (e.g., see 'Budgetary Structure and Classification of Government Accounts, p 15). As we shall see, the Swedish practice cannot be accepted for an underdeveloped country like Pakistan because of the particular character of its economy.

The concept as used in Sweden:

Now what are we to understand by 'financial soundness' of the government ? Let us study this concept as used in a country like Sweden where budgetary policies are framed with significant economic considerations in view.

In Sweden the concept of financial soundness was incorporated in budgetary policy in the 1930's, and has continued since then. The extent of financial soundness of the state is measured by changes in its net assets. By assets, however, is meant only those assets which are profitable, or revenue-producing in the financial sense. That is to say, only those assets are included in the state's balance sheet which yield a revenue at not less than the prevailing rate of interest, which could be obtained if the asset were ~~sold~~ not bought or constructed at all, so that the money spent in buying or constructing it might be lent out.

This concept of financial soundness in Sweden led to a curious line of demarcation between the current and capital accounts of the government budget. The receipts, ^{in the capital account} consist wholly of borrowings. But borrowing according to the above concept is permissible only for investments which are revenue-producing in the sense described above. All investments, therefore, which do not result in an annual flow of money are charged to the current account. This makes outlays for such non-revenue producing assets like roads and public buildings itemized as current expenditures. Not only this: if an investment is revenue producing, but the expected rate of return in money-flow falls below the current

rate of interest, a corresponding proportion of the investment is financed out of the current account, so as to make the ratio of the expected rate of return of revenue to the part of the investment financed from the capital account equal to the rate of return from lending out the money. The same procedure is followed when the government lends money at interest rates lower than the rate at which it is borrowed, and a capital gain is recorded when the loan is repaid.

This, therefore, is the way in which the soundness of the financial position of the government is interpreted under the Swedish budgetary practice. Under this practice, the balance in the current account obviously shows changes in the states's net assets in the financial sense, and therefore indicates the 'financial soundness' of the government.

Implications of this concept:

This concept of financial soundness, and the peculiar practice it leads to in respect of the current and capital accounts, implies that the state is virtually regarded as a business concern.² It should regard its assets with the business yardsticks of revenue-yielding capacity, and should be guided in its operations by the profit--or possibly 'no-loss'--- motive rather than the 'service' motive. It has a still deeper significance. All the non-revenue producing outlays, whether they are on current goods and services, or on the creation of tangible, lasting assets like roads, canals irrigation facilities and public buildings etc., have to be financed out of taxation.

2. "The Swedish double budget is an attempt to regard the public sector not as a person but as a firm or business concern....The Swedish government was led to adopt this particular method as a direct consequence of their experience in the depression of 1930-32." (Mrs. Hicks-'Public Finance'--p 370).

Such an idea may be permissible in a country where there are not enough roads to make, and not enough canals to dig. In a developed economy, where the industrial entrepreneur finds these basic facilities ready for him, taxation may possibly cover the the remaining needs which the state has to fill up. But in an underdeveloped country like Pakistan such an idea is hard to countenance. The absence of adequate basic facilities are talked about everywhere. Private entrepreneurs cannot create them out of their own means. The state, therefore, must assume the role of providing these for the economy. But the incomes of the people are meagre; they cannot be taxed to the extent which will make the financing of such outlays out of the current revenue of the government possible. Encroachment upon the capital account is, therefore, inevitable.

Modifications of the concept for Pakistan:

The concept of financial soundness as used in Sweden, therefore, needs modification to suit the requirements of Pakistan. If the financing of the non-revenue producing assets from borrowings is necessary and desirable, it is not fair to say that the government is in a financially unsound position. Under the Swedish concept of financial soundness this is what is implied. But the peculiar nature of an underdeveloped economy like ours does not warrant that we should adopt the same notion about financial soundness without qualification. Financial soundness should properly be related with the role of the government in the interest of the particular economy concerned. For Pakistan, we have discussed this

role in chapter one: one of the important roles is to contribute to the community's saving; the other is to shoulder the task of capital formation, particularly in respect of the basic facilities. The first implies that the current account of the budget should show a surplus; and the extent of this surplus will show the government's contribution to the community's saving. But the second implies that capital has to be defined in the 'social' sense, and not in the 'business' sense for our purpose. For a business concern, capital assets are "permanent assets which are intended to be continually used in the business for the purpose of earning revenue."³ But the concept of 'social capital' is not confined to assets like the above which yield a flow of revenue in monetary terms only. It also consists of the non-revenue-yielding but service-rendering assets like roads and public buildings.⁴ Although they do not typically produce an annual revenue, they may properly be regarded as adding to the nation's productive assets and, as such, capital. Since the government is not a business concern, the service rather than the profit motive should be its primary concern. It should, therefore, be interested in the social sense of capital and not in the narrow business sense. Moreover,⁵ as pointed out by Edey and Peacock, much of the government investments on roads and public buildings etc. is "very similar to business investment" even; "if, for example, a political decision

3. Advance Accounting--Batliboi, p 99.

4. Some of these assets, of course, are partially revenue-producing--for example, hospitals and certain school buildings when fees are charged for their use, and some communication services for which 'tolls' are charged.

5. 'National Income and Social Accounting', p 52.

were made to pass the provision of schools and housing back to private enterprise, all expenditures of this kind would be recorded as investment in the 'private sector' from which factor incomes in the form of rent and profits would flow for many years." From this consideration also such assets deserve to be treated as capital!

Capital so defined, 'saving' also assumes a particular meaning in this context. Saving is abstention, out of current revenue, from consumption and other non-investment expenditure, as against investment; but investments are taken to be not only those in the financially productive sense, but also those which render a distinct 'service' to the economy over a number of future years. The government of any underdeveloped economy, if it has a positive saving in this sense, may by all means be said to be in a ~~finally~~ financially sound position. If the budgetary balance in the current account is to reflect this financial soundness, the two accounts have to be so separated that this balance may show the government's contribution to the community's saving as defined above.

Net and Gross savings:

Along with the above definition of saving it is also necessary to be clear whether it is to be regarded as a gross concept or a net concept. Gross saving is that which is available for investment consisting of creation or acquisition of 'new' assets as well as expenditure on repairs and replacements of existing assets. Net saving, on the other hand, is the difference between gross saving and expenditure on repairs and replacements. In the present paper, saving will throughout be viewed as a net concept, for the reason that it is the net, and not the gross capital formation that

really increases the nation's productive power and as such may be said to contribute to the development of the economy. Since for net capital formation there should be net saving in the economy, it is the concept of net saving that is the more important from the point of view of economic analysis and planning for the development of an economy.

2. The Lines of Demarcation between the two accounts for the General Government sector

Expenditures:

The line of demarcation in respect of expenditures follows directly from the definition of saving given above. All expenditures should be shown in the capital account which result in the creation or acquisition of social capital, either revenue-yielding or service-rendering; outlays which do not result in any such productive assets should be shown as current expenditures.

In a broader sense, however, social capital not only includes the tangible assets which yield a flow of revenue or services, but also such intangible assets like health, literacy and other human qualities. Expenditures which increase or improve such assets, or in other words expenditures on the 'development of human beings', therefore also demand places in the capital account. But for obvious reasons it is impossible, first, to arrive at an objective valuation of such assets and, second, to be certain whether an expenditure intended to increase a certain human quality really does so or not. Further, as 'Budget

6. For example, a wrong policy might, in respect of say education, stand in the way of knowledge rather than increase it; but for a tangible asset like roads the result is visible enough.

Management' says, "once this concept was accepted,..., it would be extremely difficult to establish a clear-cut line of demarcation between expenditures for human welfare and expenditures which tended to increase the productivity of human beings.⁷" For example, it cannot be found out which part of a certain 'health' expenditure results in increase in people's health and hence productivity, and which part results in increase in comfort and hence welfare.

It is, therefore, not convenient to incorporate the concept of ⁱⁿ⁻tangible capital in our definition of capital expenditure. Capital expenditure, therefore, should be taken as expenditure which results in the creation or acquisition of tangible assets which yield a flow of revenue or services to the economy over a number of years in the future.⁸

The question of repairs and replacement expenditures:

One knotty problem emerges from the above definition. Should an expenditure for repair or renewal of capital be regarded as a capital expenditure or not? These expenditures do ^{not} create assets in the sense of adding capital in a new form, but does so

7. p 18.

8. The question was raised in the 'Workshop on problems of budgetary classification and management' as to how to treat additions to real assets resulting from discovery of new natural resources (e.g., the discovery of a coal-mine). Since natural resources are not 'created' by government outlays, they are not regarded as government capital formation, and are to be normally recorded as changes in the national wealth account, if there is any. Expenditures on such items as 'power surveys', therefore, ought not to be recorded as capital expenditures.

in the sense of 're-creation' of portion of assets lost due to wear and tear (perhaps this may be viewed as analogous to recreation or revival of lost energy of a human being that nevertheless does not increase his power potential). Part of these assets may be financed from special funds like depreciation or renewals reserve funds created out of the revenue account from year to year, and these do not offer much difficulty. For as the provision is made from the revenue account for depreciation, and the money is taken over to the capital account as a receipt, the increase in money capital offsets the loss in real capital. The total value of real and money capital (the value of real capital remaining unchanged) then remains the same as before, so that the lost real capital is already 're-created' in the form of money capital or, what amounts to the same thing, real capital is converted into money capital. The subsequent expenditure from the depreciation fund on replacement or repair is simply the reconversion of money capital into real capital, without any net decrease in capital in the money or real form taken together.

Expenditure on replacement and repairs of capital financed out of depreciation and similar funds, therefore, may be regarded as capital expenditure as it does not go against our idea that the current balance should show the net, and not the gross, saving which is available for net capital formation. Since provision for depreciation is made from the current account, the saving that is finally shown in the current account does make itself available for net capital formation.

This, however, does not apply to those cases where provisions for repairs and replacements are not made from the current account annually and transferred to the capital account. In such a case there is no re-creation of real capital lost due to wear and tear until the lost portion is actually replaced. In the absence of any depreciation or renewal funds, this replacement will have to be financed from usual capital receipts such as loans, if the item is charged to the capital account. Such an operation will imply conversion of money capital into real capital resulting in decrease in money capital in order to maintain the value of real capital intact. The total capital--money and real--, therefore, shows a corresponding diminution.

It is, therefore, not legitimate to show replacement and repairs expenditures, not financed from special funds created out of the revenue account, as capital expenditures. These should be treated as current expenditures instead. Only by so doing can the balance in the current account be made to represent the net saving that is available for net capital formation.

It may, however, be desired that the capital account should show the gross as well as net capital formation. In such a case, the expenditure may be shown as a capital item, with an additional operation, viz., a corresponding write off to the current account and transferring the money from the current to the capital account, so that the saving in the current account may still offer itself wholly for net capital formation.

National Defence outlays:

Having laid down the line of demarcation between current and capital expenditures, it may be worthwhile to point out one of its important implications. This is in respect of national defence outlays. The prevailing practice in Pakistan appears to be to separate defence outlays into current and capital ones on the basis of life expectancy.⁹ However, from the point of view of economic analysis,--which is the motive for laying down the above definition of capital expenditure,--mere life expectancy is not a sufficient criterion for separation. For, a large proportion of military installations do not add to a nation's productive assets in the sense of providing for the future a flow of income or services, and as such do not contribute to capital formation of the economy,¹⁰ inspite of the fact that their life-expectancy may extend well beyond the accounting period. Such outlays, therefore, cannot be regarded as capital expenditures.

9. The 'capital outlay on defence services', for example, shows items like 'works', 'equipment', 'plant and machinery' (vide Demands for Grants); vide, also, 'Public Finance Surveys of India' for a criticism of the Indian capital budget in respect of defence outlays (p 32).

10. It might be felt that consideration should be taken of the fact that certain military assets, e.g., airfields, warehouses, etc., might be put to civilian use at a later period, and as such cannot be said to be economically unproductive for all times to come. But as there is no way of knowing whether a particular military asset will definitely be so used at a later period or not, it is not possible to make any allowance for this possibility. The definition of capital expenditure should, therefore, relate to 'original purpose' and not 'potential service'. If, however, refinement is desired, the value of the asset may be shown both as a receipt and an expenditure in the capital account in the budget of the financial year in which the military asset is transferred from military to civilian use; and, if a balance sheet for the government sector

Out of the total defence outlays, only those which create capital in the social sense, such as outlays for the construction of houses for military personnel, deserve to be treated as capital expenditures.¹¹

Receipts:

Having laid down the basis on which current and capital expenditures ought to be classified for an 'economic budget' for Pakistan, we now turn to the question of receipts. In the case of expenditure the line of demarcation has more or less offered itself from the concept of financial soundness: we have only had to add the concept of service yielding assets to the prevailing concept of business capital in order to arrive at a definition of capital expenditure. The problem of obtaining a line of demarcation for the receipts is, however, somewhat more complicated. This is because of the peculiar nature of government revenue as contrasted

could be prepared, the asset should be shown there as a capital gain for that year.

Similarly, it might also be felt that a military expenditure in the borderline, say, between India and Pakistan, may help towards preventing the smuggling of goods across the border, and as such may be said to serve a distinct service to the economy. But again there is no way of separating that part of the expenditure on military installations on the border, which results in the prevention of smuggling, from the total expenditure. Further, the service mentioned above is incidental, and does not satisfy the criterion of 'original purpose'. Allowance for this possibility, therefore, is also not practicable.

11. There seems no justification for the treatment of all defence outlays as current expenditure, irrespective of the type of assets they result in, by the ECAFE secretariat while reclassifying the budgets of a number of countries (viz., India, Burma, Hongkong and the Phillipines) for purposes of illustration and study (vide 'Report by the Executive Secretary on Economic Reclassification of Government Accounts and Budgets', presented at the seventh session of the ECAFE, p 9-10).

with the revenue of a business concern or of an individual. The revenue of the latter is derived entirely from the sale of goods — and/or services, and from other 'incomes' such as interests, commissions etc. This revenue may be said to be fixed in accordance with the ^{amount of} goods and services that the individual or concern can sell during the accounting period in question, and with the amount of capital he/it can lend or hire out. It is, therefore, not possible for an individual or a business concern to increase ^{revenue} by will. For the government, however, apart from its capacity as an entrepreneur selling goods and services, there is no such limitation in the amount of revenue it can acquire for any financial period. The reason is that the government does not only 'earn' revenue, like a business concern, but also 'raises' revenue by way of taxation out of private pockets without offering any direct 'quid pro quo'. The government can, if it will, increase its 'revenue' to almost any extent by the instrument of taxation so long as it does not exceed that vague limit, viz., the taxable capacity of the people, so as to invite revolution.

It does not at first sight appear that anything can be done about it. If one cannot stop the government from raising whatever amount of tax-revenue it pleases, one cannot apparently help if the tax-revenue pushes up government receipts in the current account. In all countries following traditional budgetary practices, all tax-revenue is shown as current receipts. But one further character of tax-revenue invites questions and criticisms of this traditional practice. The government imposes taxes not only upon private income, but also upon private property. If so,

then can we regard all tax-revenue as current receipts of the government and at the same time want that the balance in the government's current account should indicate government contribution to the nation's saving ?

By no means. For a tax upon property, if the rate of tax is high enough, will be paid not from the income account, but from the capital account, or saving, of the tax-payer. It therefore results in a diminution of the saving of the rest of the economy other than the government sector. If, therefore, such a tax receipt is reckoned in the current receipt in the budget of the government, the balance in the current account will fail to represent government's contribution to the nation's saving inasmuch as this balance includes an element which represents reduction of saving in the rest of the economy. The actual contribution of the government to the community's saving must be calculated by deducting, from the total current receipts, the amount that comes from the saving of the rest of the economy. The latter, therefore, does not deserve a place in the current account of our economic budget'.

Once this argument is accepted, it applies not only to tax-receipts, but to all sorts of receipts which are paid out of private capital. For example, receipts from the sale of land, which appears in the current account of the existing budgetary structure of Pakistan, ought to be reckoned as a capital and not a current receipt. The same applies to government administrative receipts by way of fines and penalties if the amount is large enough to force the payer to sell his assets to meet the penalty.

Limitations of the demarcating line:

It must, however, be admitted that it is not always possible to separate with precision all/receipts which are paid out of private capital from those paid out of private income. The two items which probably raise the maximum amount of controversy are income taxes and death duties. On the one hand, not all incomes are paid out of the income account of the tax-payer as we have taken above; tax-payers in the higher income brackets very often pay their income taxes from funds which would otherwise have been saved. On the other hand, a portion of estate duty may quite conceivably come out of the income account of the payer, though it is generally regarded to have come from private capital. Controversies on such individual cases are still found in economic literature, and have not yet been unanimously solved. These items have, therefore, to be classified somewhat arbitrarily, with as much support from statistical observations as is possible.

To this extent, the balance in the current account may fail to represent the true government contribution to the nation's saving. But perfection is a word alien to all social sciences, and the devise that we have suggested is certainly better than allowing all tax-revenue to be shown in the current account, which in effect leaves for the government the wide possibility of showing a surplus by increased death duties and capital levies, a possibility that an unprudent government might well be tempted to seize(perhaps in order to avoid criticisms resulting from an otherwise unbalanced budget); in the latter case the budgetary balance would clearly lose all its economic implications, but

in the method suggested here it can at least claim to an approximation to the government's contribution to the nation's saving. And taking into consideration the fact that the error on one side will to some extent cancel out along with the error on the other, it may reasonably be hoped that the approximation will be a close one.

3. The Enterprise Account

On the basis of the above criteria, the general government account of the 'economic budget' for the government sector can be separated into two parts: current and capital. The balance in the current account represents the saving of the general government sector, and will move to the capital account to join other capital receipts to finance expenditure on the creation or acquisition of capital.

The total contribution to the national saving by the central government sector as a whole, however, is not given by the saving of the general government sector alone. To this must be added, first, the saving of the public undertakings taken together. This will be given by the current balance of the 'enterprise account', or by an aggregated 'profit/^{and}~~er~~ loss account'. This account will obviously be prepared on commercial principles as we discussed in chapter three.

The two 'surpluses of profits':

Care must be taken, in calculating the 'surplus of profits'-- as the balance in the profit and loss account of an enterprise is termed--, and adding it to the surplus in the general government account, so as to avoid double counting in cases where the surplus of profit of a particular public undertaking is by legislature

transferred to the general government account as a receipt (current) of the latter (e.g., as in the case of the Railways and the Posts and Telegraphs). In such a case, since the surplus in the general government account is calculated after taking into account this transfer as a receipt, the surplus of profits in the enterprise account, if it is to be added to the surplus in the general government account in order to arrive at the total saving of the government sector, must exclude such transfers.

The amount involved in the transfer, however, represents the profit of the particular undertaking concerned in the true sense of the term. It must, therefore, be taken into account if it is desired to find out whether the enterprise sector of the government as a whole is paying its way or whether it has to be subsidized out of tax-revenue. Such information is necessary for policies as regards subsidies to, and directing price policies for, particular undertakings.¹²

We have, therefore, two 'surpluses of profits' for the enterprise account. One is for calculating the total contribution of the government sector to the nation's saving, and the other for seeing whether the government enterprise sector as a whole is paying its way or not. These surpluses, and their differences, will take the following form as outlined in table 1 below:

12. For example, the government may decide to allow a particular public enterprise to operate at a loss so long as some other public enterprise is registering gains of an offsetting amount; the former undertaking may be subsidized out of the general revenue, while the profits of the latter transferred to the same, so as to keep the position of the general revenue intact.

TABLE 1

(The total surplus of the general government account and the enterprise account taken together)

1. Current account of the general government sector

tax and other current receipts ---- A	current payment and transfers to the public ----- G
surplus of profits of Railways, Salt etc. --B	subsidies to public undertakings ----- D
	surplus -- (A,B) - (C,D) --- X

2. Aggregated profit and loss account for the enterprise sector

trading profit --- E	interests (payments) --- G
interests (receipts) -- F	first surplus of profits --- (E,F) - G --- Y
subsidies received --- H	appropriations to general revenue ----- I
	second surplus of profits ---- (Y,H) - I --- Z

From this table we get:

- I. The net operating position of the enterprise sector of the government, independently of the transfers to and from the general government account; this is given by the first surplus of profits, Y.
- II. The total surplus of the two accounts taken together; this is given by the surplus in the general government account, X, plus the second surplus of profits in the enterprise account, Z.

The table shows the following identities:

$$1. B = I;$$

$$2. H = D.$$

4. The Accounts of Funds

Secondly, account must also be taken of any saving that may result from the operations of the reserve funds before the total saving of the government sector can be arrived at. For this, the receipts and disbursements of the funds ought to be separated on the same principles that we have advocated for the general government account. We have seen in chapter two that the budgetary treatment of the accounts of the government funds in Pakistan is not satisfactory, because (a) all receipts to and payments from the funds are recorded as capital items; (b) the budget totals are unduly inflated. We shall, therefore, make an attempt to find out some device for a more satisfactory treatment of the accounts of the funds.

Separation into current and capital accounts necessary:

First, it is necessary that the transactions of each fund should not all be shown as capital items,-- for they are not all so,--but should be separately shown in a current account and a capital account. On the one hand, if the receipts consist of transfers from the current side of the general government account, they should be treated as current receipts of the fund concerned. This, we have seen, happens in the case of all the funds save the fund for Social Uplift Schemes. If the receipts consist of transfers from the capital side of the general government account, they ought to be treated as capital receipts in the fund's account. This will happen in the case of the Social Uplift Fund, which was created out of revenue surpluses,--and hence savings,-- of the government for two successive years.

On the other hand, the expenditures ought to be classed as current and capital items on the same principles as in the general government account, so as to permit aggregating of the budgetary balances.

The problem of overstatement of the totals:

Second, the transactions between the general government account and the account of the funds should be treated in a way as to avoid overstating the budget totals, a defect inherent in the prevailing practice in Pakistan. The different methods of allocating money to the various funds may be said to have the following common characteristics:

- (a) to transfer the amount concerned to the fund as an item of current expenditure in the budget;
- (b) to show the same as a receipt to the fund concerned in the capital account of the budget;
- (c) to show the expenditures met from the funds as capital expenditures in the budget; and
- (d) the absence of necessary deductions in the budget totals for the above double entries both on the receipt as well as the expenditure side.

In order to correct the defect mentioned, the most economic and straight forward method seems to be that followed in the U.S.A. in respect of some 'Trust Funds' like the "Old age and survivors' Insurance Trust Fund". This method consists of

- (a) deduction of the amount concerned straight from the receipts side of the budget as an appropriation to the

trust fund concerned, so that the total receipt in the general account does not include this receipt;

- (b) to show the same as a receipt in the account of the fund, and
- (c) to show the expenditure met from the fund only in the account of the fund and not in the general account of the budget.

This method may easily be adopted for the 'economic budget' of the Pakistan government, remembering that a deduction from the current receipt of the general government account has to find its counterpart in the current, and not capital, receipt in the accounts of the funds (in U.S.A. there is no distinction in the reporting budget between current and capital transactions), so that the current and capital accounts show uniform line of demarcation in both the general government and the fund accounts.

A parallel method may be adopted in the 'return' case, i.e., when money is transferred from a fund to the general government ~~accou~~ account, as in the case of the Social Uplift Fund. In such a case, (a) the amount concerned is to be deducted from the total expenditure in the general government account before arriving at the total expenditure 'from' the same account, i.e., total expenditure financed from general government receipts; and (b) the same amount is to be shown in the fund account as an expenditure of the fund effected 'through' the general government account, as against expenditure through the fund direct.

In a tabular form, these 'inter-account' transactions may take the following form:

TABLE 2

(Inter-account transactions between the general government account and the accounts of the funds)

1. General Government Account (current)

total receipts	---	A	total expenditure	---	D
deduct-appropriation to funds	----	B	deduct-amount met from funds	--	E
Net total receipts	---	A	net total expenditure from the general government account	---	D - E
	----	B		---	F
		C	surplus	---	C - F
				----	G

2. Aggregated account of the funds (current)

total receipts	---	H	expenditure direct through the funds	-----	I
			expenditure through the general government account	--	J
			total expenditure from the funds	-----	I, J
				-----	K
			surplus	---	H - K
				-----	L

The identities in this table are:

1. $H = B$;

2. $J = E$.

Finally, a particular feature about the fund transactions deserve mention. There are certain funds such as the Social Uplift Fund, to which money appropriations are not made regularly every year; instead, lump sum transfers are made in particular years, and the amount is required to finance the funds' expenditures for a number of future years. In such cases, the current account of the fund will not show any receipt except for the year in which the lump transfer is made. As such, the maintenance of two separate accounts--one current and the other capital--may be meaningless from the administrative point of view. The maintenance of a separate current account becomes necessary from the administrative point of view only when there is a question of covering current expenditure with current receipts. But such a question is clearly irrelevant for funds of the type mentioned above.

Nevertheless, an economic budget demands such a treatment if it is intended to show the total saving of the public (central government) sector for any financial year. For when a lump sum is transferred to a particular fund out of the revenue surpluses of any particular year, and the whole of this amount is not spent from the fund during the same year for current purposes, the unspent portion clearly represents a saving for the said year, and has to be regarded as an opening balance for the next financial year (assuming there is no capital expenditure from the fund); but, on the other hand, if a portion of this opening balance is spent for current purposes in the next financial year, it amounts to dissaving, and must be taken into account while arriving at the total saving of the government sector as a whole for that year.

A current account, therefore, has to be prepared where the total current expenditure will be shown as a deficit.

Before concluding this section, it may be noted that for the accounts of the funds the cash basis of accounting is appropriate on the same grounds that we studied for the general government account in chapter three. The functions of the funds are part of the general government functions as opposed to enterprise functions to which the term 'public undertaking' is related.

5. The total saving of the central government sector as a whole

We have now arrived at our target. We set out to devise methods by which the total savings of the public (central government) sector could be calculated from the current accounts. We can now say that this saving will be represented by the sum of the savings in the three accounts, viz., the general government account, the enterprise account and the funds account. Proper treatment of signs (surpluses or deficits) has, of course, to be borne in mind.

We have also seen that the savings in the general government account and the enterprise account have to be arrived at after taking into account of the fact that the 'surplus of profits' of some public undertakings are transferred to the general government account as a receipt.

The calculation of the total savings needs amalgamation of the two tables presented in this chapter. This amalgamation is outlined in the following table:

TABLE 3
(the total saving of the central government sector)

1. Current account of the general government sector

tax & other current receipts--A		current payments and transfers to the public ---	F
surplus of profits of particular undertakings--- B		subsidies to public undertakings ---	G
total receipts -- A,B --- C		total expenditure ---	H
deduct-appropriation to funds ----- D		deduct-amount met from funds -----	I
net total receipts -- C - D ---E		net total expenditure from the general government account--- -----H - I -----	J
		surplus ----- E - J ---	X

2. Aggregated profit and loss account of the enterprise sector

trading profit ---- K	interest payments ---- N
interest receipts --- L	first surplus of profits --- K,L - N ----- O
subsidies received --- M	appropriation to general revenue ----- P
	second surplus of profits --- O,M - P --- Y

3. Aggregated current account of the funds

total receipts ---- Q	Expenditure direct through the funds ----- R
	expenditure through the general government account ---- S
	total expenditure from the funds ----- T
	surplus -----Q - T ----- Z

The identities in this table are:

1. $B = P$; 2. $M = G$; 3. $Q = D$; $S = I$.

The required total saving of the central government sector is given by X,Y,Z.

CHAPTER V

ECONOMIC CHARACTER CLASSIFICATION

In chapter one we discussed the need for 'economic character classification' of the items of transaction, as opposed to classification on the basis of 'function' or administrative unit. The economic distinction between current and capital transactions is a part of 'economic character classification', but we have dealt with it in a self-regarding chapter in view of the many complications involved in such a distinction. In the present chapter we shall deal with the classification requirements within each account separately, so as to render the economic budget useful from the point of view of (a) national income calculation, and from the broader point of view of (b) economic analysis and policy for the development of the economy. The two points of view are complementary, and not infrequently the solutions will coincide. For example, while national income accounting requires the segregation of 'economic' and 'transfer' payments and receipts, economic analysis requires the same segregation in order to study the redistributive effects of government receipts and expenditures. The problem of economic character classification, therefore, will be tackled simultaneously from these two points of view.

1. Separation between 'home' and 'foreign' transactions

Before dealing with the classification requirements for the accounts of the different parts of the central government sector--viz., the general government account, the enterprise account, and the funds account--, we should note one

particular category of classification which is to be maintained in all the accounts throughout. This is in respect of 'home' and 'foreign' transactions. We have seen that the present budget accounts of the government do not distinguish between the transactions in home and foreign currencies respectively. But for an 'economic budget' such a distinction is essential, and will serve the following important purposes:

First, it will give an idea of the impact of the budget proposals on the domestic price-level. This impact can be estimated by calculating what is known as the balance of the 'income payments' account of the government sector. An income payments account shows the transactions between the government and the income account of the public. This can be directly drawn from the budget accounts if the latter are properly classified according to economic characters. But a budget which shows a deficit in the income payments account does not necessarily imply that the government transactions as proposed will have an inflationary effect over the domestic price-level. In spite of the deficit in the income payments account, payments at home may fall short of receipts in home currency, if the government sector imports large amount of current goods and services from abroad. In such a case, the potential inflationary effect of government transactions is not allowed to operate on the domestic price level but is transferred 'beyond the border'. Similarly, the apparent deflationary effect of a budget surplus in the income payments account may be offset if the payments at home exceed receipts in home currency. These vital factors in determining the impact of government transactions on the economy, and the latter is again

1. see note 1 to this chapter.

a vital consideration in formulating economic policy.

Second, the separation of domestic from foreign transactions will directly assist the construction of the nation's balance of payments for the financial year and the contribution of the government sector to the same. The position of the foreign exchange resources is an important factor that affects and conditions developmental planning, because economic development in an underdeveloped country requires the availability of a significant volume of goods and services from outside.

Finally, such a separation will directly help national income calculation. The national income of a country equals the economic earnings of the inhabitants from within the country (which is equal to economic payments by the inhabitants to each other), plus net incomings from abroad in the form of incomes and gifts etc. It, therefore, requires separate calculation of domestic and foreign payments and earnings at each level.

2. Classification within the general government account

(a) current receipts:

We shall now turn to the classification requirements within each account separately. First let us take up the current receipts of the general government account.

tax and non-tax revenue:

The most obvious and one of the most important distinction is that between tax-revenue and non-tax-revenue. Tax analysis has a distinct place in public finance and is an important guide to economic policy. However, for analytical purposes, the distinction

between tax revenue and non-tax revenue is not so clear today as is implied in standard text-books on public finance. A tax is commonly understood to be a compulsory levy by the government on the people without any assurance for a direct return in goods and services. It is in this sense that a tax is also understood by the administrative machinery of the government concerned with the collection of taxes. For analytical purposes, however, this definition suffers from limited scope and tends to generate wrong implications of government policy.

Government participation in and aids to business enterprises, and their effects on tax analysis:

Tax analysis is today facing a crisis because of the modern tendency of governments to (i) directly enter the field of enterprise to carry on with commercial undertakings which profits or losses, and (ii) to help business enterprises with subsidies etc. The implications of these two operations of a modern government is remarkable in the context of tax analysis.

(i) surplus of profits yields tax revenue in disguise:

A government commercial undertaking yields profits or losses in the same way as a private concern does, but these are not subject to the same fiscal treatment, nor do they have the same effects as the latter.

On the one hand, the profits (total revenue - total costs) of a private business concern may be broken down into the following component parts:

- (a) the portion that is taken away by the government in the form of indirect taxes;
- (b) the portion that is taken away by the government in the form of direct corporation tax;
- (c) the portion that is taken away from the shareholders in the form of income tax;
- (d) the portion that is left to the shareholders in the form of personal income;
- (e) finally, the portion that is left to the concern as undistributed profits, which is usually carried over to its capital account;

AS against this distribution, the whole of the receipts of a public undertaking such as, for example, the Department of Salt, accrue to the treasury in the form of 'receipts from the sale of government salt' in Pakistan. Since the tax-collection machinery of the government is not concerned with these commercial receipts, no portion of it is reckoned as a tax-receipt--either direct or indirect-- in the budget. This diminishes the importance of tax-analysis from two points of view:

First, total tax-receipts are viewed without taking into account items corresponding to (a), (b) and (c) above, which, from the analytical point of view, ought to be regarded as tax-receipts; this results in understating the tax-receipts. No analysis of the total effects of taxation on the economy can give a complete account so long as the government is capable of taxing the community; without saying that it is doing so, through the disguise of monopoly power in the field of enterprises, and this fact is

not taken into account in the tax-analysis.

Second, it offers the government an important source of raising revenue, the element of taxation in which is not so obvious as the administrative tax-receipts; hence government tax policy cannot be properly appreciated without having in view the magnitude of 'surplus of Profits' from such public undertakings whose operating surpluses accrue wholly to the treasury such as in the case of salt, Railways etc.

(ii) Subsidies are negative taxes:

On the other hand, there is another side of the picture. This relates to a public undertaking which may be operating at a loss covered by subsidies from the general revenue of the government. If a private undertaking suffers from losses inspite of operating under minimum cost conditions, it means that the consumers are not paying enough for its goods and services to enable it to remain in the business. If it enjoys monopoly power, it will raise prices; if it does not, it will be forced to go out of business. But a public undertaking operating at a loss may do neither. Its losses may simply be covered out of general revenue of the government. This would mean that the consumers are allowed the benefit of consuming a commodity at a cost less than the operating costs of the undertaking. It therefore amounts to virtual return of part of the indirect taxes taken from the consumers in connection of other commodities, subject to indirect taxation, for which the consumers are paying more than costs. Analytically, therefore, such subsidies represent negative indirect taxes.

This conclusion applies not only to public undertakings whose losses are met from the general revenue of the government, but also to those private business concerns, if any, which are subject to price controls, and subsidized in order that they may cover the corresponding loss.

Search for an analytical distinction between tax and non-tax revenue:

These two considerations indicate that the common idea of a tax as a compulsory levy by the government on the people is not satisfactory from the point of view of economic analysis, though from the administrative point of view nothing more is desired. An 'economic budget' of the government which distinguishes items of transactions according to economic and not administrative significance, must take into account the element of taxes, positive or negative, disguised in the profits and losses of those public undertakings whose profits accrue to the treasury and whose losses are met from the treasury, and in subsidies to private concerns to cover deficits or losses.

(i) treatment of the surplus of profits:

Among the literatures in modern budgeting, mention is found of these complications in the 'Budgetary Structure and Classification of ²Government Accounts'. But the solution offered in it is not wholly satisfactory. In respect of the surplus of profits, it suggests two totals of tax-receipts,--the first is the traditional total tax-receipts as viewed by the administrative machinery; the second adds the whole of the surplus of profits of the public undertakings to the first total.

But the whole of the surplus of profits does not represent tax; part of it is the income of the owner (in this case the government itself), as we saw while breaking down the profits into its component parts (item d). The second total of taxes as laid down in the above literature, therefore, overstates the tax receipts.

A more logical procedure is actually practised in the budget system of the government of Italy. There the 'net profits' of public undertakings like Salt and Tobacco (known as 'fiscal monopolies') are calculated after taking into account, along with operating expenses, a flat percentage of gross sales receipts which is assigned to the budget as a 'tax-revenue', obviously as a substitute for receipts from indirect taxes which would otherwise have accrued to the state had the undertaking not been under public ownership. This 'net profit' is then recorded in the budget under 'net profits from fiscal monopolies'. From the administrative point of view such recording of the revenue from 'fiscal monopolies' under two separate heads in the budget amounts in effect to the same thing, i.e., both the component parts accrue to the treasury as revenue to be budgeted for general expenditure. But from the point of view of economic analysis this undoubtedly approached the notion of tax receipts in a wider sense, the need for which we have already indicated.

The Italian practice, therefore, provides us with the direction in which refinements in respect of tax-reckoning in the economic sense may be obtained. This does not, however, give the

ideal solution. For even in the 'net profits' from fiscal monopolies calculated after deducting the element of indirect taxes, element of direct taxes is concealed. For, a government that taxes the net profits of a private company, as well as the income of its shareholders, as the government of Pakistan does, is deprived of this source of 'tax-revenue' (in the administrative sense) if the company is owned by the government itself. For analytical perfection, therefore, it is necessary that the government should tax itself, not only in the form of an indirect tax like duty on sale of government salt, but also in the form of direct corporation and income taxes on the 'net profits' from such undertakings.

If, therefore, the surplus of profits of a public undertaking accrue to the budget account of the general government sector as a receipt, it has to be entered under three separate headings:

(a) indirect taxes from public undertakings, assumed to be levied at a rate according to the nature and importance (and similar considerations as are applied when levying indirect taxes on the produce of a private concern) of the business carried out by it. This should be added to the current operating expenses of the undertaking before arriving at the net surplus of profits (the first surplus of profits we noted in table one, chapter four). Incidentally, this will have the additional advantage of making the operating results of the public undertakings directly comparable with those of competing undertakings, if any, in the private sector which are subject to indirect taxation in the usual way;

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(b) direct tax upon the 'net profits' of the undertaking (gross profits minus indirect tax-element), at the usual rates of corporation taxes, plus direct tax upon the residual profits, corresponding to the direct tax on personal income of the shareholders (the government is the sole shareholder here, and as the whole of the profits accrue to the treasury, there is nothing corresponding to the undistributed profits of a private concern for the public undertakings we are speaking about here);

(c) Net income of the government as the owner of the undertaking; this equals the part left out after 'paying' all the tax-elements, and is the government's 'personal income' to be reckoned as the proper non-tax-revenue for analytical purposes. Since, however, this portion will also have been shown as 'income' in the account of the undertaking concerned, it should take the form of 'non-tax transfer from public undertakings' and not 'income', in the general government account so that the total income of the public sector is not overstated.³

Once such refinements are adopted, they should be applied not only to those cases where the 'surplus of profits' of a public undertaking (e.g., Salt) accrues to the treasury, but also to those cases where the government is a shareholder of an undertaking, public or private (e.g., the Government of Pakistan holds shares in a public undertaking like the P.I.D.C., and also in a private undertaking like the National Bank of Pakistan). For the dividend that flows from such shares would be subject to income taxation if the shares were owned by private persons, and the government ^{can} ~~cannot~~ at any time increase its income tax-receipts by selling some of such shares to the public, or can reduce income

tax receipts and yet increase its total revenues by purchasing more of such shares. These dividends must, therefore, be reckoned in the 'economic budget' in two parts: one under 'income taxes' collected from the government itself, and the other under 'net income from shares' after deducting the former from the dividends.

It may appear that according to this principle other earnings of the government such as interest from loans and earnings from administrative services like licence fees etc. should also be treated in two parts in the 'economic budget' in the same way as the profits from public undertakings or dividends from shares. But this is not so. A case for such a treatment crops up only when government earning is a substitute for private earning. For unless this is so, the mere fact that the government earns money from a certain source does not understate the total tax-receipts from the point of view of economic analysis; it does so only when the earning concerned would have yielded tax-receipts if it accrued not to the government, but, instead, to some private individual or body. Now the administrative earnings of the government are clearly of such a nature that cannot be earned by a private body in place of the government; they are intimately linked up with the administration of the various government departments. And as for earnings in the form of interest from loans, it is understood that in principle the government does not offer loans to others as a normal source; the government is not a commercial bank, and provides loans to private bodies only when it is satisfied that (a) the loan would benefit the economy, and (b) other sources of loanable funds are not available to the borrower. Government earnings of interest, therefore, cannot be said to be substitutes of private earnings.

(ii) treatment of subsidies:

WE have found out a method of transferring the 'surplus of profits' of public undertakings to the general government account in a way so that tax-analysis is not impaired from the analytical point of view. We now turn to the case of subsidies to undertakings, private as well as public, given out of the general revenue to enable the undertakings to cover their losses. We have argued that they are nothing but negative taxes from the point of view of economic analysis. It therefore follows logically from the principle we have advocated in respect of the 'surplus of profits' that these should be shown on the receipts side of the general government account of the economic budget as a negative tax-item.

Before going over to the other classification requirements for the current receipts, we may summarise our conclusions in respect of the analytical line of demarcation between the tax and non-tax receipts. The tax receipts will consist of the following:

- (a) all the administrative tax-receipts, i.e., the compulsory levies on the public without any direct 'quid pro quo' (some public undertakings like the P.I.D.C. are subject to these taxes;
- (b) the element of indirect taxes, present in the gross receipts from sale of goods or services by a public undertaking, if the same is not otherwise included in (a);
- (c) the element of direct taxes present in the net profits of a public undertaking when the whole of the net profits accrue to the general government account;
- (d) the element of direct taxes present in the dividends that the government earns from its shares in undertakings, public or private;

(e) the subsidy granted from the general government account to undertakings, private or public, to cover their losses.

Other classifications of current receipts:

Apart from the distinctions between tax-and non-tax revenue, the following distinctions on the receipts side of the current account will facilitate economic analysis and national income analysis and accounting:

Direct and Indirect taxes:

The effects of these two types of taxes on the economy are different and as such deserve separate treatment. (Indirect taxes directly affect market prices and have regressive effects on the distribution of national income). The line of demarcation between direct and indirect taxes may be treated according to conventional definitions, subject to the qualification that both direct and indirect taxes should include their counterparts, in the transfers of profits or losses from an undertaking to the treasury, in the way as discussed above.

Earnings and non-tax-transfers:

The rest of the receipts may be separated into (a) earnings of the general government account through the various factors of production at its disposal, i.e., income from property such as rents, income from loans (interest), incomes from administrative services such as fees, and income from the sale of 'incidental' government products like jail manufactures (for which separate commercial accounting) is not desirable; and (b) non-tax-transfers, from various sources like subordinate governments (grants, contributions etc.), public undertakings (transfer of 'net profits'

after deducting the tax-elements), private bodies and individuals etc.

Total 'transfer' receipts of the general government sector will consist of the sum of these non-tax-transfers and the tax-receipts. These transfer receipts, in so far as they come from sources within the country, will cancel out in national income accounting.

Sub-classifications:

Apart from these broad heads of classification, each such head should show, at the minimum, whether the receipts are from (a) the public undertakings covered by the 'enterprise account'; and (b) from the rest of the economy. This separation is necessary in order to facilitate the preparation of a consolidated account of the whole central government sector which will set forth the aggregate picture of all transactions in this sector. In such a consolidated account, the transfers between the different accounts of the central government sector will have to be cancelled out.

Further sub-heads may be inserted showing the detailed breakdown of the sources of receipts, such as agriculture, industry, mining, educational institutions, local governments etc. Such a breakdown will always be welcome to a planning machinery in that it will provide valuable information which may guide the machinery as to the choice of distributing the ~~the~~ sources of taxes and other receipts among different sectors of the economy. This, however, requires a high degree of accounting skill and improved accounting practices at the department and still lower levels, and may be deferred until accounting practices are improved.

Treatment of tax-refunds:

Finally, a country like Pakistan where tax-administration involves substantial tax-refunds, such refunds should be shown on the receipts side as deductions from tax-receipts, in order that the total budgetary receipts is not unnecessarily inflated by this item (this practice is already being followed in Pakistan).

(b) current expenditure:Economic and transfer payments:

Corresponding to the distinction between earnings and tax-and-non-tax transfers on the receipts side, there should be a distinction between economic payments, which are made in exchange for some economic goods or services (e.g., wages and salaries, expenditure on consumable goods, etc.), and transfer payments, which are payments with no corresponding return in goods and services rendered (typical instances are superannuation pensions, grants to educational institutions, scholarships, etc.). Like the transfer receipts, these transfer expenditures will also cancel out in national income accounting, in so far as they are made within the country.

One of the items about which confusion may arise as to whether to treat it as a transfer or an economic payment is interest payments on government debt. This cannot be 'prima facie' classified without an enquiry into the use made by the government out of the borrowed money. For example, a debt which is incurred with a view to financing a war cannot be said to perform any direct economic service to the economy, and as such the interest payment should properly be regarded as a transfer. But, on the other hand, if

the borrowed money is spent on productive purposes, the loan can be said to have served a distinct interest of the economy, and as such the interest payment should be treated as an economic payment. Now since in our economic budget we have placed all non-productive expenditures in the current account, and all debt receipts in the capital account, the loans are understood to be financing the productive outlays of the government. Therefore, unless the current account shows huge deficits which makes the encroachment upon borrowed money for covering the deficit inevitable (as a first resort there are capital receipts other than loans in the capital account, such as receipts from estate duties), borrowings may be normally taken to finance the productive investments of the government. Interest payments, therefore, deserve their place as economic, and not transfer, payments.

Sub-classifications:

As on the receipts side, sub-heads should separate payments to the public enterprises covered by the 'enterprise account' from payments to the rest of the economy for facilitating a consolidated account. Further sub-heads may show detailed breakdown of the payments according to :

(i) nature of economic payments, i.e., whether they are spent on consumable goods or services or on durable goods such as machinery. Though most expenditure on durable goods will be shown in the capital account, there will still be some, e.g., expenditure on durable defence installations, and some expenditures on replacement

4. see p 69; as stated there, the replacement expenditure may be shown in the capital account if a corresponding charge is made to the current account as a write off; in such a case, the charge will be shown as a transfer expenditure in the current account.

on capital where depreciation accounts are not provided, which will not satisfy the definition of a capital expenditure we have suggested in chapter four; these, therefore, will be shown as current expenditures. However, they are distinct from expenditure on consumable goods and services in that they are likely to be reckoned as capital receipts in the accounts of the recipients, while the latter will generally go to their income accounts. This distinction, therefore, is essential for national accounting and also for finding out the balance in the 'income payments accounts' we have referred to earlier;

(ii) other characters of economic payments for goods and services, i.e., whether they are payments for wages and salaries of government employees, payments for goods and services purchased from business concerns, rent of buildings or interest payments;

(iii) recipients of government expenditures both transfer and economic, if possible, and ^{if} similar classification is also maintained on the receipts side. The sub-heads of transfer payments in this connection will take the form of 'states and local governments' (contributions and grants), 'institutions' (grants to schools etc.), 'persons' (scholarships, pensions etc.) and others.

Transfer receipts (tax and non-tax) and transfer payments together constitute the redistributive transactions of the government, which is one of the important functions of the government we saw in chapter three. ⁵ Detailed information as regards the sources of such receipts and recipients of such payments provide valuable guide as to the results of these

transactions on the redistribution of the national income among different classes of people and different sectors of the economy. Such detailed breakdown, if possible, will therefore serve as important guides to economic analysis and planning.

(c) capital receipts:

Borrowing and non-borrowing receipts:

The most important distinction among the capital receipts is that between borrowing and other receipts. The extent of internal borrowing is a guide to the voluntary saving of the community and an important factor in ^{the} formulation of policy as regards deficit financing ⁶ and foreign finance, for borrowing usually covers the bulk of the capital receipts of the government. The effects of government borrowing on the economy is also distinct from other receipts of the government of a capital nature, such as receipts from estate duty and sale of land. Government borrowing, because of the security involved in it, tends also to divert ^a loanable funds from the natural money market, and the government is capable of stabilising the loan market to some extent by its ⁷ loan operations.

Government borrowing may be shown on a 'net' basis on the receipts side, rather than showing 'gross' borrowing on the receipts side and repayments on the expenditure side, for it is net borrowings that is available for investment purposes.

6. A note on deficit financing is added to this chapter in the end.

7. In an underdeveloped country like Pakistan, characterised by relatively undeveloped and disintegrated money markets, this factor is of limited interest.

Sub-classifications for 'borrowings':

For purposes of economic analysis and policy it is essential that government borrowing should be sub-classified according to the sources of the money. The three main sources of borrowing are (a) the state bank, (b) the commercial banks, and (c) other private bodies and individuals. It is widely known in economic circles that the effects of borrowing from these three sources respectively upon the economy are different. As a general rule it can be said that other factors remaining the same, borrowing from the state is most likely to generate an upward pressure on prices, and borrowing from private sources other than commercial banks the least. The distribution of public borrowing among these three main sources, therefore, is an important choice as regards policy.

Borrowings may also be sub-classified into 'long term' (e.g., permanent debt) and 'short term' (e.g., treasury bills) as they also have different effects on the money market.

Sub-classifications for non-borrowing receipts:

Capital receipts other than borrowing may be sub-classified according as they are:

- (a) Repayments of loans;
- (b) Receipts from the sale of government assets like land, shares, etc.; these may be further sub-classified into 'real assets' (e.g., lands) and 'financial assets' (e.g., shares);
- (c) Taxes generally falling upon the capital accounts of the payers (e.g., death duties, capital levies, etc.);
- (d) capital grants and aids; the bulk of this class of receipts is likely to take the form of foreign aids and grants;

classification of the latter (b) may be made, if possible, according to the characters and recipients of the expenditures in the same way as suggested in respect of current expenditures; this will help measuring the balance of the 'income payments account'.

Financial investments may be sub-classified according as they result in the acquisition of real capital (physical assets), like lands and buildings, or financial assets like securities.

Indirect investments should be sub-classified according as they are granted to this or other sector of the economy. A knowledge as to what extent government loans benefit the different sectors of the economy is an important guide to the formulation and appraisal of government loan policy.

3. Classification Within the Account of the Funds

The classifications within the accounts of the funds will take the same character as those in the general government account. Some items will, of course, be absent in the funds account, particularly on the receipts side. For example, current receipts of the funds will wholly consist of transfers from the general government account of earmarked receipts or 'ad hoc' grants; the capital receipts, on the other hand, will solely consist of 'drawal from cash balances and current surpluses for the year, if any.

Current expenditures of the funds will show a separate category where it is involved, viz., 'expenditure through the general government account'; we have come across this item in chapter four, table two. The detailed breakdown of this item will be shown in the general government account. Other expenditures

On the expenditure side, the trading account will show

- (a) economic payments, sub-classified as in the general account;
- (b) inventory adjustments;
- (c) allowances for depreciation and renewals.

The profit and loss account:

The profit and loss account will represent the true profit or loss positions of the enterprise sector and hence its saving or dissaving. The receipts side of it will consist of

- (a) trading profit, if any, and (b) interest receipts, and (c) subsidies received, if any, from the general government account.

The expenditure side will show (a) interest payments, sub-classified into 'interest payments to the treasury' (general government account), and interest payments to other bodies; and

- (b) indirect taxes, 'real' or 'virtual', paid to the treasury (virtual tax is the tax element in the surplus of profits); and
- (c) appropriations to the treasury (first surplus of profits minus second surplus of profits, as we laid down in chapter four, table 1).

The capital account:

The receipts side of the capital account will show:

- (a) the carryover from the current balance, i.e., the portion of the surplus of profits (second) that is retained in the business after distribution of dividends to shareholders;
- (b) Allowances for depreciation etc., transferred from the trading account;
- (c) borrowings, sub-classified according as they are 'advances from

will be classified in the funds account according to the same principles inunciated in respect of the general government account, such as distinction between economic and transfer payments in the current account, and between real and financial investment and between direct and indirect investment in the capital account.

4. Classification within the enterprise account

The current account of the enterprise sector has to be divided, according to commercial principles, into two parts, viz., the trading and the profit and loss account¹⁰

The trading account:

The trading account will show, on the receipts side, only receipts from the sale of goods and services of those undertakings which engage in such dealings (e.g., Railways, state trading, etc.). These receipts should be sub-classified into (a) receipts from the central government, which will equal the sum of the economic payments to the enterprises shown in the general government account and the funds accounts; this will facilitate the consolidation of the total accounts of the central government sector. (b) receipts from the rest of the economy.

10. The trading and profit and loss account are relevant only to 'trading' concerns. For non-trading concerns there would be no trading account, and an income and expenditure account will take the place of the profit and loss account (see 'Advanced Accounting, Batliboi, p 108). The classification in the income and expenditure account will follow about the same pattern as in the general government current account, and are not discussed here in order to avoid repetition.

treasury' and 'borrowings from outside'. The latter may further be subclassified according to the term or source as in the general government account.

(d) repayments of debts;

(e) net capital gains, if any, from revaluation of assets; ~~and~~

(f) fall in cash balances, if any; and

(g) increase in currency circulation by the state bank, which is an important item making up the total deficit financing incurred by the central government sector.

The capital expenditures will show the following classifications:

(a) Real investments and (b) financial investments, in the same way as in the general government account; these should again be subclassified into gross and net investments, and also according to the character of the payments involved;

(c) repayments of debts, sub-classified according as they are repayments to the treasury, if any, and to others.

5. The Consolidated Account

After classifying the items in all the accounts in accordance with their respective economic characters, the final step in preparing the economic budget is the preparation of a consolidated account for the whole of the central government sector. The consolidated account will give the aggregate figures for all the economically significant items, such as taxes, incomes, economic and transfer payments, real and financial investments savings, etc.,

for the whole of the central government sector.

The purpose of consolidation is to find out the position of the central government sector as a whole viz-a-vis the rest of the economy in the matter of financial transactions, so that all the inter-account transactions have to be cancelled out in the process of consolidation, leaving only the transactions between the central government sector and the rest of the economy.

The consolidated account will serve as an invaluable guide to indicate the effects of the transactions of the central government sector taken as a whole over the economy, particularly on such economic phenomena as national income and employment and capital formation.

Before concluding the discussion of the economic accounts of the central government sector, two more concepts--viz., the income payments account and the concept of deficit financing--, will be taken up for consideration in the notes to this chapter.

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NOTES TO CHAPTER V

1. The Income Payments Account

We have divided the economic budget of the government into two accounts--current and capital-- in such a manner that the balance of the current account gives an indication as to the contribution of the central government sector to the national saving. There is another concept necessary for national income accounting and economic analysis which is particularly helpful in assessing the inflationary or deflationary effect of government transactions on the price level. This is the balance of the income payments account. The latter breaks down government transactions into receipts from and payments to private income and capital accounts. The difference between the receipts from and payments to private income accounts represents the net subtraction from or additions to the private income accounts as a result of these transactions, and therefore indicates their net impact on the price levels.

The income payments account, as we have discussed before, is relevant only for domestic transactions of the government, since it is the domestic price level we are interested in.

Now how are we to draw the income payments account ? It must be noted that just as in the case of receipts it is not always possible to separate those receipts from the private accounts which come from private income from those coming from private capital, with precision, similarly it is not always possible to draw a clear line of demarcation as regards payments.

However, some broad rules can be inunciated, just as in the case of receipts, for the payments also, so as to lead us to as close an approximation as is possible; and economic analysis has to accept many such approximations.

For the receipts side, we have already segregated receipts from private income and capital accounts into the current and capital account respectively of the economic budget. The current receipts of the government, therefore, will represent the receipts side of the income payments account.

As for expenditures, the current account of the economic budget is not a true indication of the payments to private income accounts. On the one hand, current expenditures contain expenditures on some non-productive durable goods like plants and machinery for defence installations and may also show replacement of capital. Money spent on durable goods may generally be taken to be reckoned in the capital account of the recipient. These, therefore, must be subtracted from the government's current expenditures in order to arrive at the payments to private income.

On the other hand, the capital expenditures of the government contain expenditures on productive durable goods as well as real investments for the construction of new assets and for the purchase of capital from abroad. Since the 'domestic' real investment consists of expenditure on current goods and services (any machinery for, say, the construction of a road will be reckoned as a financial investment), they also can be taken as payments to private income accounts.

The income payments account will therefore consist of :

total receipts from private income account = total receipts
'at home' in the current account of the economic budget;

total payments to private income accounts = current
expenditures at home in the economic budget, minus
domestic expenditures on durable goods shown in the
current account, plus real investments for the
construction of new assets within the country shown
in the capital account.¹¹

If the receipts exceed the payments, then government transactions may be taken to have deflationary effects on the domestic price levels; if payments exceed receipts, then an inflationary effect may be predicted.

11. The 'Budgetary Structure and Classification of Government Accounts' seems to have neglected the expenditures on defence installations while indicating the payments to private income accounts due to government transactions. According to it, "the government's current account outlays plus the real investment portion of the capital account will represent additions to private current or income account" (p 23).

2. The concept of Deficit Financing

This note is inserted in order to discuss the changing meaning of the concept of 'deficit financing' in economic literature. This concept has been given increasing attention since the Keynesian revolution brought into light the necessity of budget deficits in order to fulfil the government's economic duty towards the state.

Both the classical economists--starting from Adam Smith-- and the Keynesians have used this concept to mean loan-financed expenditure, as against expenditure met from 'normal sources' of government revenue (which excludes net borrowing and decrease in cash balances). In modern literature also the same meaning is mostly found of the concept.¹² There is moreover a tendency in some quarters to identify 'deficit financing' with budget deficits.¹³ Recently, however, a new meaning of the concept of deficit financing is being given in some quarters which at the same time attaches a quite different and limited meaning to 'budget deficits'.

This new trend is particularly marked in countries where the government has adopted the 'double budget' system, or the principle of dividing the budget totals into a current and a capital account. In these countries the budget deficit is used as a concept relevant to the current account only and not the difference between the total expenditure and total 'normal revenue' as implied in countries with the single budget system; it is the excess of current expenditure over current receipts. The line of

12.e.g., see Public Finance, by U.K. Hicks, chapter xix.

13.e.g., see 'Deficit Financing for Economic Development with Special Reference to ECAFE countries'; in 'Economic Bulletin for Asia and the Far East, vol v, no 3.

demarcation between the two accounts, however, is more or less arbitrary in some cases (e.g., India and Pakistan),¹⁴ so that in reality a budget deficit becomes nothing more than a mere accounting entity useful perhaps to the administration, but not to the economist.

The new concept of deficit financing is, on the other hand, much more meaningful. It has originated from a change in the idea as to what is normal government receipt and what is not. The classical economists could not conceive of borrowing as a normal receipt as they thought that government borrowing tends to divert loanable funds from productive to unproductive uses. The Keynesians showed that this is not necessarily so, and that the government can serve the economy an important service by borrowing the otherwise 'idle' money from the public and investing them in productive purchases, thereby filling up the saving-investment gap. The necessity for the government of borrowing money from the public with a view to spending the same for productive purposes is particularly urgent in underdeveloped economies where whatever saving takes place tends to be invested on land and commerce rather than in formation of capital for reasons widely known. If the government, by offering lucrative securities, can divert those savings towards the formation of capital, it will be doing a distinct service to the economy.

If this is accepted, then there is no reason to regard borrowing as an 'abnormal' receipt for the government, and hence constituting deficit financing. If government expenditures

14. see 'Public Finance Surveys of India', United Nations, p 31.

consist not only of unproductive, but also of productive outlays, then borrowing is quite an obvious and normal means of financing them.

In short, the 'norm' of public finance has changed. And along with it the concept of deficit financing. The modern tendency is to identify deficit financing not with the gap between total government expenditure and total normal sources of revenue, but with an altogether different factor--viz., creation of new money. Whatever the government may be able to raise, as its receipts, in the form of taxation or borrowing, from the existing supply of money in the economy, is regarded as a regular and normal receipt and as such not contributing to deficit finance. But if and whenever the money supply has to be inflated in order to provide the government with finance otherwise unavailable from the existing money supply, it is held that a deficit financing has been incurred in its modern sense to the extent of the increase in the supply of money. In order to arrive at a measure of deficit financing, therefore, we have to look into the sources of government finance which are likely to inflate the supply of money in the economy. These sources are:-

1. Borrowing from the central bank;
2. Borrowing from the commercial banks; and
3. Running down of cash balances held with the central bank.

Each of these ways of financing expenditure results in inflation of the money supply unless the bank or banks concerned effects a corresponding reduction by, for example, calling back

loans previously granted to some other sector of the economy. Now the central bank, whose primary aim is to watch over the monetary system, will not effect such offsetting influences unless it is convinced that the inflation of currency will be harmful for the economy, and that the calling back of loans will not go against the interest of the economy. It is difficult to satisfy both the conditions simultaneously; for the central bank does not usually grant loans to any party unless the loan is expected to benefit the economy, so that the calling back of the loan may not be desirable even if the total loans granted by the central bank goes up to such an extent as to generate an excessive increase in the money supply. Normally, therefore, items (1) and (3) above, which result in increase in note issues, contribute to deficit financing to the full extent.

As regards government borrowings from the commercial banks, however, no such general conclusion is possible. As a rule, the commercial banks work with the profit motive, and will readily offer loans to the government by increasing deposits, which means additions to the supply of money. However, for a net increase in bank deposits corresponding to the banks' subscription to government loans, one condition must be satisfied, namely, that the banks must possess excess reserves. Otherwise they will be forced to call back loans to other sectors of the economy if they decide to, or have to, subscribe to, government loans, so that there may not be any net increase in bank deposits.

Now in underdeveloped countries commercial banks generally possess excess reserves, from a consideration of security

against risks involved in loan operations. These may provide as outlets for net increase in deposits corresponding to government borrowing from these banks, provided the banks are willing to let their excess reserves fall. Whether the banks are actually willing to bring down their excess reserves in this way cannot be said, however, without considering actual data of their practices. It is, therefore, not possible to give any generalized answer to the question as to the extent to which commercial banks' subscription to government loans results in increase in money supply and hence constitute deficit financing.

From the point of view of economic analysis and planning it is necessary to arrive at a measure of the extent of deficit financing incurred by the government. Other things remaining the same, deficit financing represented by additions to money supply results in an upward tendency of prices. This factor must be taken into account while formulating economic policy.

Deficit financing for the central government sector as a whole:

We can easily extend the above analysis to indicate the constituents of deficit financing incurred by the government sector as a whole. In the consolidated statement of the transactions of the whole central government sector, where the state bank also finds a place according to the suggestions made in this paper, government loans subscribed by the state bank ^(and also government withdrawal of cash balances from the central bank) will cancel out as an intra-governmental transactions. A new item, however, appears in the picture that constitutes a contribution to deficit

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financing, i.e., the net increase in the currency in circulation through notes issued by the state bank.

The factors contributing, partly or wholly, to deficit financing incurred by the whole of the central government sector, therefore, are:-

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- (a) ~~total fall in cash balances owned by the central government sector;~~
- (a) (a) borrowings by the government institutions from the commercial banks; and
- (b) (b) net increase in the currency in circulation through the state bank.

CHAPTER VI

THE ECONOMIC BUDGET VS THE ADMINISTRATIVE BUDGET

1. The Conflict

We have completed our enquiry into the structure and requisites of an economic budget for the central government sector in Pakistan. A big question mark, however, is expected on the administrator's table after all this. We saw at the very outset of this paper that from the administrative point of view the government budget is a very powerful instrument for controlling the financial operations of the various government departments. The essence of this control lies in the practice that all the money receipts are carried to a central pool and are allocated from there for different purposes as laid down in the budget, and that a set of machinery works to see money being spent exactly in the manner as provided in the budget. But can this practice continue as effectively as before if the economic budget is to replace the traditional administrative budget? In whatever way the traditional budget may be unintelligible to the economist, it is obviously as intelligible to the administrator as the economic budget to the economist; for the structure of the traditional budget rests essentially upon administrative convenience. Once it is gone, the machinery set up to see that money is spent according to the provisions in the budget will be left with provisions with so much money, say, for real investment, and so much for financial investment, without implying whether it is a hospital or a road that is desired to be built. Such a state of affairs cannot be countenanced by the legislature,---who votes the budget,---for it leaves the detailed decisions to some such body as perhaps a

Secretary of State as under the Government of India Acts before 1937, and thus virtually identifying the legislature with nothing more than a body of economic planners. Here, therefore, is a clear conflict between the economic budget and the administrative budget.

2. Attempts at a Compromise

(a) Hicks' 'The Problem of Budgetary Reform':

Attempts to solve this conflict by different academic circles are as instructive as they are interesting. Hicks, for example, gives predominant weight on the administrative side, maintaining that economic character classification is permissible only in so far as it does not collide with administrative convenience. "The first objective of a public accounting system," he says, "...is to give a clear and intelligible picture of the government's own transactions. For this purpose it must be based upon criteria which arise out of the government's own transactions, not upon criteria which are relevant only to the other side of those transactions which concern the private sector of the economy."¹ (the relations with the income and capital accounts of the private sector). From this stand Hicks rejects the exclusion of capital taxes from the revenue account, and maintains that the necessary adjustment may later be made when the national income and expenditure account is prepared.²

(b) U.N.O.'s 'Budgetary Structure and Classification of Government Accounts':

On the other hand, 'Budgetary Structure and Classification of Government Accounts' presents a general framework that attempts

1. The Problem of Budgetary Reform--p 63.

2. Ibid--p 64.

a compromise between the two approaches. The Introduction, given to the 'Technical Appendix' in the above book says, "It would be rather difficult and perhaps an impossible task to develop a set of model public finance accounts, equally satisfactory from the point of view of budgetary procedure and from the point of view of social accounting requirements. Nevertheless, government accounts could be organized in such a way as to provide a reasonable basis for economic analysis, while maintaining the elements which are essential to meet the traditional/ budgetary requirements."³

The compromise suggested in this book also, like Hicks' work, makes it necessary for one or the other party to accept a sacrifice. For example, subsidies to enterprises, which ought to be reckoned as negative indirect taxes from the economic point of view, has not been so reckoned, leaving it for the statistician⁴ to "make necessary adjustments" when required.

3. Conclusions:

These two examples should make it clear how experts have struggled to satisfy both the parties--the legislature and the economic planner--at the same time. In so doing, they have laid down recommendations that warrant sacrifices on one or the other party. Apart from the obvious need for 'functional classification', as against economic character classification, from the administrative point of view, there are other reasons why such a compromise does not seem possible or acceptable by either party or both. Of these, two deserve special mention:

The first arises from the creation of a number of 'funds' from the general revenue receipts, and showing the disbursements of these funds separately. From the point of view of economic

budgeting it is necessary, we have seen, that the transactions of these funds should be separated into a current and a capital account just as in the case of the transactions in the general government account. But from the point of view of the administration and management of the accounts of these funds, such a separation is utterly meaningless, and perhaps inconvenient too. For while in the general government account the receipts can be grouped into two such accounts which can possibly serve as sources of current and capital expenditures respectively, the receipts in the funds account consist of only one category, viz., transfers from the general revenue, and therefore form a single source out of which all expenditures from the funds---current and capital---have to be financed. We have seen that economic budgeting would require the reckoning of the receipts to the funds as 'current' for the year in which the money is transferred from general revenues, and as 'capital' in all subsequent years. But this will unduly complicate the administration and management of the accounts of the funds, which can be best served by keeping a single account each for receipts and disbursements to and from the funds respectively (perhaps that explains why under the present procedure in Pakistan all receipts to the funds are reckoned as capital receipts and all expenditures as capital outlays).

The second reason arises from a wider angle. The budget in the ultimate sense is the plan of the legislature or parliament as to how government money has to be raised and spent. The parliament consists of the elected representatives of the people who, therefore, are the ultimate dictator of government fiscal

policy. The parliament, however, can never accept the needs of the economy, as such, as the only guide to policy; it has other important considerations to be taken into account, such as the consideration of the security of the state, and that of political stability. For example, emergency defence expenditures which cannot be financed from taxation at the normal rate may be considered as an item which can justly be financed out of loans; though the burden of the debt will fall upon future generations who will not get any economic return in goods or services from the loan, they may be expected to content themselves with the feeling of security which might have been absent had the emergency defence expenditure not been incurred. Political considerations might be attached to it if increase in taxes were expected to lead to political oppositions. Such expenditures do 'waste' loanable funds by spending them for unproductive purposes, and to that extent the future generations will lose potential increase in the nation's productivity. But these are cases where the economist has no authority to interfere. All he can do is to make clear to the people the economic implications of the proposed expenditure from loans, and for this the economic character classification of the budget is the ideal way. But once it is recognised that the legislature may justifiably decide to finance an unproductive expenditure from borrowing, the need for a system of accounts that distinguishes expenditure financed out of taxation and out of borrowings respectively, according to decisions taken by the legislature, cannot be denied. The economic character classification would show the unproductive

expenditure as current outlays, and would cover the resulting deficit if any in the current account by transferring money from the capital account to the current; but from the administrative point of view, which aims at ensuring that monies raised from particular sources are spent for the particular purposes as decided upon by the legislature, an 'administrative classification' of government accounts is, therefore, essential.

We must therefore conclude that whereas economic character classification of government accounts is essential for purposes of economic analysis and planning, it cannot be regarded as a substitute for the traditional administrative classification. The latter deserves to be kept where it is, and the former needs only to be added to it in the form of perhaps an explanatory memorandum or appendix.

However, it may help to clarify confusions if the separation of the administrative budget into a capital and a current account is discontinued. Since there is a tendency to attach specific economic meanings to these terms in most quarters, it is desirable that a consistent meaning be adhered to whenever such decisions are made, rather than subject it to ad hoc decisions by the legislature. We have recommended such a meaning in respect of our economic budget. For the administrative budget, distinctions between tax-financed expenditure and loan-financed expenditure or similar other distinctions should be sufficient for purposes of administration of public money in accordance with the plans of the legislature.

CHAPTER VII

SUMMARY AND CONCLUSIONS

Introduction:

We have now concluded our study. We started in chapter one by pointing out the need for economic budgeting for the central government sector in Pakistan; in chapter two we satisfied ourselves that this need has so far been overlooked in framing the budgets by the government; and in chapters three to six we studied the possible framework of an economic budget for the government sector and tried to solve the various problems involved.

In the present chapter we shall summarise our main findings as to the requirements of an economic budget for the central government sector, and end with some concluding remarks. The summary will not be presented chapwise; instead, a picture of the said requisites from an overall viewpoint will be presented.

1. Summary of Conclusions

The three accounts:

To start with, the economic budget of the central government sector in Pakistan should be divided into three accounts, as follows:

(1) The first, called the 'general government account', will show the transactions of all those departments which do not fall under the category of 'public undertakings' as defined below. (A 'department' is spoken of as a functional entity and not necessarily as a separate administrative body; the same administrative body, such as the 'Department of Food and Agriculture', may in the functional sense be conceived of as having two separate 'departments', such as 'State trading' and the 'general administration of food and agriculture').

(2) The second, called the 'enterprise account', will show the transactions of all those 'departments' which can be termed as 'public undertakings'. A 'public undertaking' is defined as one which is owned,--wholly or partly but nevertheless retaining full control,--by the government and for which it is desirable as well as practicable to have an independent commercial accounting system.

(3) The third, called the 'fund account', will show the transactions of the various 'reserve funds' of the government of Pakistan set up from time to time for specific purposes.

Accounting bases:

The cash basis of accounting, showing the actual cash transactions during the year in question, is appropriate for the general government account and also for the fund account. For the enterprise account, however, the 'accrual basis' of accounting, which recognises the need for showing rights accrued and liabilities incurred, that for stock taking, and for depreciation accounting, must be adopted.

Current and Capital Account:

Each of the three accounts, in its turn, will be divided into two parts: the current and the capital account. The line of demarcation between the two will be such that the balance in the current account may reflect the 'financial soundness' or otherwise of the government. For the enterprise account, this automatically follows if the current account coincides with the 'profit and loss' account in the proper commercial sense, which recognises inventory

adjustments and depreciation allowances, and sets down as current expenses all outlays which do not result in the acquisition or creation of 'productive' assets in the financial sense.

For the general government account and the fund account, however, the concept of financial soundness must allow for (a) the need for large scale government investments in the construction of certain types of non-revenue producing but 'service rendering' assets like roads, and (b) the possibility of raising money by taxation, other than by borrowing, falling upon the capital account of the tax-payer. Under these characteristic features of government operations, capital expenditure for the general government sector and the funds should be defined as expenditure which results in the creation or acquisition of tangible assets which yield a flow of revenue or service to the economy over a number of years; on the other hand, capital receipts should be defined as all those receipts which, taken generally, come from the capital account or saving of the payer (e.g., borrowings, receipts from the sale of assets, estate duties etc.). The current account has to be made of all other receipts and expenditures.

With these lines of demarcation between the current and the capital accounts, the current balances in each of the three accounts may be said to reflect the saving of the corresponding sector of the government; the total saving of the central government sector will consist of the algebraic sum of the three balances.

Economic Character Classification:

The transactions in each account should be classified according to their economic characters, which will also take into account the characters that are relevant for national income accounting. First of all, separation between domestic and foreign transactions have to be made throughout the accounts. Other broad economic character classifications will be as follows:

(a) Both receipts and expenditures have to be divided into 'transfer' and 'economic' items. Transfer receipts will consist of taxes, aids, grants etc; transfer expenditures will consist of grants, pensions, scholarships etc. Economic transactions will consist of those made against some economic goods or services.

(b) For analytical purposes, taxes have to be identified not only as those which are called taxes in the administrative sense, i.e., receipts without any corresponding direct 'quid pro quo'; on the one hand, government's incomes as the owner of public undertakings have to be 'taxed' in the conceptual sense just as the income of the owner of a private business undertaking, and, on the other hand, subsidies to both private and public undertakings in order to cover their losses should be reckoned as negative taxes. Such a treatment of taxes in the analytical sense is essential in order to save tax-analysis from the crisis it is facing because of increasing government participation in enterprise activities and assistance to particular enterprises.

(c) Capital receipts should be classified into borrowing and non-borrowing receipts; borrowing must be classified according as the source is the public, commercial banks, or the state bank.

(d) Capital expenditures should distinguish between direct and indirect (e.g., loans) investments, and also between real and financial investments. Real investment is defined as outlays for the purchase and /or construction of new physical assets for the economy (e.g., the construction of buildings, the purchase of machinery from abroad); financial investment is defined as the purchase of assets previously existing in the economy (lands, shares etc.). Real investment measures the direct real capital formation by the government for the economy.

Each of the broad classes should, whenever possible, be subdivided according to detailed economic characters and according to the source or direction of receipts and expenditures respectively.

The final step in economic budgeting will consist in consolidation of the three accounts, cancelling out the inter-account transactions in the process. The consolidated account, showing the economic character classification of the transactions, will indicate the position and importance of the central government sector vis-a-vis the rest of the economy, and will be an invaluable guide to analyse the economic impact of government transactions taken as a whole over the economy.

The Income Payments Account:

An 'income payments account' should be part of the government's economic budget, and can be calculated directly from the framework of the economic budget outlined above. This account will breakdown government transactions into receipts from and payments to private income and capital accounts. The difference

between the receipts from and payments to private income accounts represent the net impact (inflationary or deflationary) of government transactions on the price level.

Deficit financing:

A.B. Borrowing as such is no longer regarded as a part of deficit financing as previously. The modern tendency is to identify deficit financing with the creation of new money for financing a deficit. For the government sector as a whole, the factors that contribute, partly or wholly, to deficit financing in this sense are: (a) ~~total fall in cash balances owned by the government sector~~, (b) borrowings by the government institutions from the commercial banks, and (c) net increase in currency circulation by the state bank.

The economic budget vs the administrative budget:

Finally, the economic budget is not proposed as a substitute for the traditional administrative budget, as the latter is essential as an instrument of administrative control of and decisions regarding government transactions, decisions which do not rest upon economic considerations alone. The former should properly be a complement to the latter. However, in the interest of avoiding confusions, the separation of the administrative budget into a capital and a current account ought to be discontinued.

2. Concluding Remarks: the Economic Budget and the Five Year Plan

Nothing could probably serve as a better conclusion of this work than some illustrations of the possible relation it could have with the five-year plan for Pakistan, the draft for which happily came out before the work was completed. The plan is in a sense a huge budget, not for a single coming year, but for five years taken together. Moreover, it is not a budget merely for the government sector, but for the monetary transactions of the whole economy. It is, in short, a five-year national economic budget' for the country.

The Public sector:

We shall concern ourselves with the two chapters of the plan that have direct relevance with government budgetary structure and classification of its accounts--namely, the chapters on 'Internal Financial Resources' (chapter eight) and 'Public Saving' (chapter nine). It must be noted at the outset that the public sector as conceived of in the plan is more comprehensive than the 'central government sector' whose budgetary problems we took up for our present study. The public sector is comprised of the central government sector as well as the provincial and local governments with all the institutions under their control. It is obvious that in order to arrive at any aggregate figures for the whole of the public sector for economic analysis, the structures of the provincial and local government budgets have also to follow the same structural framework as the central government budget. In other words, 'economic budgeting' has to be adopted

by the subordinate governments as well as the central government.

Rearrangement of budgetary items for the plan:

The first point to note about the plan is its recognition that public saving "should not be confused with a surplus in the revenue budget"¹. That is encouraging; for we know how in the past this confusion has in fact been made both by the government and academic quarters, by taking the surpluses in the revenue budget, ceterus paribus, to indicate a sound financial position of the government. It was found necessary by the planning board to undertake "both a consolidation and a reclassification of items shown in the published statements of receipts and disbursements issued by the Central and Provincial Governments, and the elimination of all the inter-government transactions"². This confirms the necessity of providing supplementary budget data arranged and classified specifically to facilitate economic analysis and planning.

The reclassification plan adopted by the planning body, however, shows some conceptual differences with the plan that has been worked out in this thesis. These differences need clarification and deserve some comments.

(1) The concept of saving:

The concept of saving used in the plan is a gross concept, without making any deductions for provisions for depreciation of physical capital. In other words, saving is that portion of gross income that is available for 'developmental expenditure', whether

1.p 307.

2.p 368.

for replacement or for expansion of the nation's productive assets. In the present thesis, on the other hand, it has been suggested that all replacement expenditures should be financed either out of depreciation funds provided out of the current account, or out of the current account directly or in the form of write offs if no depreciation fund is provided. The saving in the current account of our economic budget, therefore, is the net and not the gross saving. This treatment seems superior to that of the plan on the ground that it provides with an approximate measure of the domestic sources available for 'net' capital formation for the economy. From the point of view of development of the economy it is the rate of 'net' and not the 'gross' capital formation that is relevant, for replacement of capital worn out merely keeps the existing rate of productivity at the former level, without contributing in any way to increase in productivity and national income. Depreciation of capital is, strictly speaking, 'consumption of capital', and saving that is available merely as an offset to capital consumption is no saving at all.

It would, therefore, be more appropriate if the plan had shown an estimate of the saving calculated on a net basis after deducting from gross income depreciation and replacement provisions. Calculation of saving on a gross basis that does not indicate the proportion of this saving that is available for actual expansion of capital resources rather than replacement of capital, may lead to an undue complacency about the availability of domestic resources for new capital formation. In case the

3. In the note, added to the appendix at the end of this paper according to the reclassification procedure as adopted in the plan,

proportion of net to gross saving is actually low, this may cause the planners to overlook the need for more stringent domestic policy in order to increase the rate of saving available for net capital formation.

(2) The concept of developmental expenditure:

The concept of developmental expenditure as used in the plan includes outlays not only on tangible capital assets as we have defined it in chapter four, but also "outlays on certain new or expanded schemes in the field of education, health, Village AID and other social services which, although not resulting in the creation of new physical facilities, serve to increase the community's intangible productive capital, by raising the fitness and skill of the people."⁴ We came across this idea in chapter four, and preferred to leave outlays on intangible capital from the capital account on the ground that it is not certain whether an expenditure intended to increase a certain human quality really does so or not, and if it does, to what extent.⁵

it is estimated that the gross saving of the central government for the budget year 1955-56 (budget estimate) is 45988 thousand rupees. Out of this, however, 52200 thousand rupees consists of depreciation and renewal provisions and other repairs and replacement expenditures. The net saving, therefore, is negative to the extent of 6312 thousand rupees; in other words, there is actual net dissaving. In spite of the possible errors in our reclassification that may have resulted from inadequate statistical information, the above figures give an indication as to the direction of gross and net savings which discredits any complacency that may result from looking at the figure of gross saving alone.

4. pp 306-307.

5. pp 66-67.

The issue invariably involves value judgements which will differ from person to person, and as such the economist had better leave the item out of the capital account altogether in order to be precise and avoid arbitrary judgment as far as possible. This is, however, not an argument against reckoning such expenditures as developmental by some planning authority. If the planner is given extra-economic authority to regard "certain new or expanded schemes" on social improvement as really contributing to an increase in knowledge, skill or fitness, a judgment which the economist as such is not in a position to question, it is perfectly legitimate to include outlays on such schemes as developmental expenditure. In such a case such outlays will find their place in the capital account of the economically reclassified budget, so that the calculation of saving from the current account will necessarily exclude them from the list of current expenditures.

(3)

Taxes and Public Saving

The actual estimate of the public saving for the five years covered by the plan has been made by dividing estimated receipts into revenue-receipts and non-revenue receipts, and expenditures into development and non-development expenditures. Public saving is then taken to be given by the difference between revenue-receipts and non-development expenditures. The published draft of the plan does not provide a breakdown of the above heads into sufficient details, so that it is not possible to see whether each item individually justifies its inclusion under the head assigned to it in the draft. However, out of the broad breakdown of revenue receipts and non-development expenditures provided in

the draft,⁶ the inclusion of the whole amount of tax-collections as a revenue receipt invites criticism. It cannot be denied, as we argued in chapter four, that part of the tax-collections come from the capital account/^{or saving} of the tax-payer rather than his income account. To the extent that this takes place, there is a corresponding reduction in private saving which must be deducted from public saving in order that public saving plus private saving may equal total saving of the economy. The best mechanism for this, as we have seen, is to reckon taxes coming out of private saving as capital or non-revenue receipt of the government. This the plan has apparently failed to do.

It is true that the extent of taxes coming from private savings/cannot be found out with theoretical logic. This resulted in ~~such~~ proposals/^{hinted at} in chapter four that as a first approximation all income taxes may be taken as revenue receipts, and all taxes on capital like estate duties as capital receipts---a proposal which may well be considered as somewhat unsatisfactory. But the error, if any, in doing so seems to be greater on the side of income taxes rather than on that of estate duties in Pakistan, considering the relative sizes of the two collections.⁷

6. p 368.

7. The figures for income tax and estate duties of the central government for two successive years are given below:

	Revised estimate, 1954-55	Budget estimate, 1955-56
Income tax including Corporation tax	183600,000	191500,000
Estate duties	1500,000	2500,000

(vide Explanatory Memorandum on the budget for 1955-56, pp 4 & 10).

On the other hand, the size of collections of estate duties is sure to rise as methods of valuation of estates used by tax-collectors are improved: the draft plan itself has suggested some improvements in the collection of estate duties. And with it the total proportion of taxes paid out of private savings will also rise.

Above all, even granting the theoretical impossibility of differentiating between taxes paid out of income and taxes paid out of savings there remains the possibility of estimating them from actual data. It is probable that the volume of data at the disposal of the Planning Board could very well guide the Board in this direction.

From neither the theoretical nor the practical point of view the neglect of the need for reckoning taxes paid out of savings as non-revenue receipts seems to be justified. It has undoubtedly resulted in overestimation of the total saving of the economy, which could be avoided, to some extent at least, either by some theoretical assumption or some practical devise of estimation.

(4) Deficit financing and private saving:

As a final and interesting point of difference between the plan and the framework of economic budget worked out in this thesis, the extent of utilisation of private saving by the public sector as calculated by the Planning Board deserves mention. Chapter eight of the draft calculated this amount as follows:

"Public expenditure financed from domestic Non-revenue sources:

- (a) Through increase in domestic liabilities (permanent, floating and unfunded debt, and increase in deposits, etc);
- (b) Through decrease in assets (sale of land and PIDC assets, and decrease in cash)."

The above items include all those which we have taken to be contributing to deficit financing, partly or wholly---namely, borrowing from the central and commercial banks, and withdrawal of cash balances held in the central bank. That amounts to be reckoning any amount of deficit financing by the government as nothing but the virtual utilisation of private saving to that extent. But is this idea legitimate ?

We know that the direct effect of deficit financing is to increase the otherwise available supply of money in the economy, and thereby to create inflationary pressures if corresponding real resources are not made available for the absorption of the additional currency and bank deposits. Deficit financing, therefore, can be identified with private saving only if there is corresponding withdrawal of currency and bank deposits by the public so as to make available surplus real resources for utilisation by the government with the help of the newly created money. The Planning Board has actually hinted at this possibility in the draft: for example, in page 339 it has been stated that government borrowing from the banking system "do not become inflationary unless the volume of bank-financed government expenditure results in a rate of expansion of currency and bank-deposits which outruns the public's desire to save in these forms". What it means

to imply is that the public have a tendency to save part of its income in the form of currency and bank-deposits rather than in the form of securities. This 'liquidity preference' or 'hoarding' as we may term it results in decrease in the supply of money and correspondingly a 'deflationary gap'. If this gap is filled up by new creation of money through the banking system, the latter may as well be identified with private saving of a corresponding ~~ame~~ amount which is taken out of circulation with one hand (people who show liquidity preference) and replaced with the other (the banking system).

Theoretically this argument seems all right. But it is not convincing, without actual statistical support, that in practice people in an underdeveloped economy do in fact hoard substantial amount of their saving in the form of liquid money. Of the three motives for doing so, the speculative motive must be almost negligible in an economy characterised by the general absence of organised security markets. The precautionary motive is also not likely to have significant contribution to this factor for two reasons: first, people in the low income group in an underdeveloped economy can hardly afford to store money from the precautionary motive; second, the richer people who can afford to do so are in a position to keep their savings in banking institutions. Only the transaction motive can claim significant contribution to hoarding of money in the liquid form in such economies. To hold, therefore, that the actual extent of deficit financing incurred by the government corresponds exactly to withdrawal of money from

the economy by the public seems to be too stretched an assertion. Further, even granting that the liquidity preference of the public is significant, there is no indication that attempts to measure the extent of idle money is actually done by the government before borrowing from the state bank or running down cash balances. About the past, therefore, it cannot be accepted that the extent of deficit financing by the government of Pakistan has had any connection with people's desire to hold money in the liquid form. But ∇ this is what the unqualified identification of deficit financing with private saving in the liquid form as made by the plan seems to suggest.

So far as the future--say the period covered by the five-year plan--is concerned, it is possible to ∇ bring deficit financing into relation with private saving in the liquid form only by a well-designed process of calculating the latter. In such a case the government will have to permit itself to incur deficit financing only to the extent given by the said calculations and no more, whatever, be its other sources of money receipts and total expenditures. Unless the government is prepared and promises to do this, deficit financing cannot be accepted, ceteris paribus, as an item of private saving. And even this provided, there is always ∇ the possibility that a part of the idle money may be activated any time; if and when this happens, all calculations and plans will be totally upset.

Summary of comments:

To sum up our comments on the plan: first, the calculation of savings on a gross basis, without including depreciation and

replacement provisions, as an item of current expenditure, does not indicate the saving that is available for net capital formation for the economy, and hence does not directly indicate the increase in the national product during the plan period; second, the failure to account for the fact that some taxes are paid out of savings, rather than out of incomes, of the tax-payers has resulted in overestimation of the total savings for the economy; finally, the identification of deficit financing as an item of private saving is open to question unless the government is prepared to incur, during the plan period, deficit financing only to the extent, well calculated, of private saving taking the form of idle currency and bank deposits, and unless the latter is assumed to persist throughout the plan period.

APPENDIX

ECONOMIC RECLASSIFICATION OF PAK BUDGET ESTIMATES
FOR 1955-56Introduction:

This appendix does not claim much importance so far as the results are concerned, and may be regarded just as an exercise. The attempted reclassification of Pak budgets was the first task that was undertaken in connection with this work, the intention being to find out the true (economic) surpluses or deficits and other analytically significant information, and to base an analysis of the budgetary policy of the government on the results of reclassification. But as this attempt failed, the focus of study had to be shifted from budgetary policy to budgetary structure. However, the attempted reclassification has been retained as an adjunct to, if not a part of, the main work as it may give an idea as to the fact that the economic balances have no connection whatsoever with the balances shown in the budget statements. As will be marked while going through the process of reclassification, a host of items have to be transferred from the current to the capital account and vice versa, and as a result the economic balances are likely to differ widely from the 'administrative balances' (they may, of course, tend to equal one another if the divergences in the receipts and expenditure sides respectively are of opposite signs and approximate each other).

Since the information provided in the Explanatory Memorandum and the Demands for Grants are not sufficient enough to help a smooth reclassification, the economic classification

of many items may appear arbitrary. For example, the receipts from the administration of Justice comprising fees, fines and forfeitures have been wholly itemized as a current receipt, while much of this--especially fines and penalties involving substantial amounts-- may have been paid from the capital account of the payer and as such, economically speaking, a capital receipt for the government budget; similarly, a portion of the expenditure from reserve funds has not been explained in the budget documents, and this portion has been totally itemized as capital expenditure on the arbitrary assumption that the amount concerned has been wholly spent on developmental purposes.

These limitations of the reclassified accounts are frankly acknowledged. They on the one hand serve to diminish the importance of the results of reclassification, and on the other hand emphasize the need for adequate information as regards the economic nature of the transactions, and proper accounting in the department and sub-department levels in accordance with the needs of economic character classification.

The composition of the reclassified accounts:

The following is an explanation of the reclassified accounts presented in this appendix:

The current account:

The reclassified current account has been divided into three sub-accounts: (a) the general government account comprising the non-enterprise transactions of the government, (b) the

enterprise account covering the departments whose functions appear to be of an enterprise nature, and (c) the fund account concerning the various reserve funds created to finance specific programmes.

The accounts are not presented in a consolidated form, i.e., the inter-account and intra-departmental transactions have not been cancelled out; for this to be done, more information would be necessary than are provided in the budget documents. The totals in this reclassified budget, therefore, are the same as shown in the original budget documents, and are overstated, as pointed out in chapter two while criticizing the present budget system of the country.

(a) the general government account: current receipts:-

The heads of revenue and the Roman numbers preceding them are the same as in the budget statement. These also include the 'enterprises', whose transactions are later deducted and taken over to the enterprise account.

Column (1) gives the total receipts under each head, taken from the budget statement.

Column (2) represents the portion of tax-revenue falling under each head; taxes are regarded here in the administrative sense only.

Column (3) gives the non-tax transfers, which are neither taxes nor incomes, such as transfers from sub-ordinate governments, funds etc.

Column (4) gives the earnings or incomes of the government, such as rents, interests, and sale of miscellaneous goods (e.g., sale of jail manufactures) and services (e.g., licence fees).

Column (5) gives the receipts of the enterprises; these

receipts are later deducted and taken over to the enterprise account.

Column (6) gives the receipts which are of a capital nature(e.g., sale of land) and yet shown as current receipts in the original budget; these receipts are later taken over to the capital account.

All the columns from (2) to (6) have been filled up from figures provided in the Explanatory Memorandum to the budget.

Current expenditures:

The heads explain the 'service, administration or area to which the demand(for expenditure grants) relates', and the serial numbers are the same as given in the Demands for Grants (for the expenditure of the government of Pakistan).

Column (1) gives the total demand under each head.

Column (2) gives the demands for economic payments, i.e., payments for goods and services(wages, salaries, rents, interests and other charges).

Column (3) gives the transfer payments such as transfers to funds, subordinate governments, and grants to educational and other institutions and to individuals.

Column (4) gives the payments of the enterprises; these payments are later deducted and taken over to the enterprise account.

1. There are departments which would invite controversies as to whether they are of an enterprise nature or not(e.g., Broadcasting); these have been retained in the general government account.

Column (5) gives the payments which are in the nature of capital expenditures (e.g., expenditures on works, plants and machinery, and stores) and yet shown as current expenditures in the original budget; these payments are later taken over to the capital account.

Expenditures shown under items 76, 78 and 80 are payments of a current nature which are shown as capital outlays in the original budget; these expenditures have been taken over from the capital account (vide capital expenditures, column 5).

All the figures have been taken from the Demands for Grants.

(b) The enterprise account:

The enterprise account has not been prepared on the principles of commercial accounting because of the lack of sufficient data; it is simply a separation of the cash transactions of the 'enterprises' from those of the non-enterprise departments of the government. The receipts of the enterprises are all incomes and the expenditures are all economic payments. The former have been taken from the Explanatory Memorandum and the latter from the Demands for Grants.

(c) The Funds account:

The current receipts of the funds represent transfers of money from the general government account to the various funds (these receipts, as pointed out in chapter two, are shown in the original budget as capital receipts).

The current expenditures of the funds have been found out from the Demands for Grants (the main budget statement shows all the expenditure from funds as capital outlays), where they are shown as amounts deducted as expenditures met from funds, and from the Explanatory Memorandum for the expenditures from the Fund for Social Uplift Schemes.

Capital Account:

The capital account comprises all the capital transactions of the government, whether they relate to the enterprises, non-enterprise departments or funds. Preparation of separate capital accounts for the enterprises and funds respectively was not considered worthwhile as, first, the enterprises under the jurisdiction of the budget have no capital receipts of their own except the provisions for depreciation and renewals of capital, all other expenditures being financed from the general account; second, the funds have nothing like capital receipts except the current surpluses and the opening balances, the latter again being merged with the total opening balances of the Treasury and are not obtained separately.

Capital receipts:

The total capital receipts have been broken down into borrowings and other non-borrowing receipts, and contain, over and above what is shown in the original budget as capital receipts, receipts of a capital nature shown as current receipts in the budget (vide current receipts of the general government account, column 6).

Capital expenditures:

The heads and the serial numbers are the same as in the Demands for Grants.

Column (1) gives the totals.

Column (2) gives the real investments like construction of buildings and roads and import of capital goods from abroad.

Column (3) gives the financial investments like purchase of land and machinery from within the country--investments which do not increase the real capital of the country..

Column (4) shows the indirect investments like loans

and advances to the public, subordinate governments and the government enterprises.

Column (5) shows the expenditures that do not result in the creation or acquisition of capital but still have been shown as capital outlays in the original budget; these have been taken over to the current account.

Finally, a summary account is given showing the total receipts and expenditures of all the three accounts taken together.

-:(viii):-

THE ACCOUNTS AS RECLASSIFIED:

Current Account

(a) General Govt. Account--Receipts:

(In thousands of Rupees)

Heads	Total	Taxes	Non-tax trans fers	Incomes	Receipts of Enterpri ses	Receipts of capital nature
	(1)	(2)	(3)	(4)	(5)	(6)
I Customs	355000	355000				
II Central Excise Duties	132500	132500				
III. Corpo- ration tax	63000	63000				
IV. Income Taxes	128500	128500				
IVA. Sales Tax	117000	117000				
V. Salt	24000	21700			2300(1)	
VI. Opium	851				851(2)	
VII. Land Revenue	2766	2766				
VIII. Prov. Excise	5707	5678		29(3)		
IX. Stamps	3764	2912		852(4)		
X. Forests	463			463(5)		
XI. Regis- tration	249			249		
XII. Receipts under Motor Vehicles Acts	1288	1288				
XIIA. Taxes & Duties under Supl. Fin. Act, '50	18500	18500				
XIII. Other Taxes & Duties	9613	7113				2500(6)
XIV. Railways (net)	91000				91000	
XVII & XVIII. Irrigation	374				374	
XIX. Posts & Telegr. (net)	10000				10000	
XX. Interest	101162			101162		

1. Sale of government salt; 2. sale of excise opium and medical opium power; 3. Miscellaneous service incomes such as fees, fines etc.; 4. do; 5. Fees and sale proceeds from timber etc.; 6. Estate Duty.

--:(ix):--

Heads	(1)	(2)	(3)	(4)	(5)	(6)
XXI. Adm. of Justice	1015			1014		1(7)
XXII. Jails & Convict Settlements	196			196		
XXIII. Police	839			839		
XXIV. Ports & Pilotage	2485			2485		
XXV. Lighthouses & Light-ships	340			340		
XXVI. Education	9670		9069 (8)	601		
XXVII. Medical	4210		3875 (9)	335		
XXVIII. Public Health	254			254		
XXIX. Agriculture	3429		2000 (10)	1429		
XXX. Veterinary	274			274		
XXXI. Co-op	14			14		
XXXII. Industries	19			19		
XXXIII. Aviation	3194			3194		
XXXIV. Broadcasting	969			969		
XXXV. Dept of Supply & Developmt.	6143			6143		
XXXVI. Misc. Depts.	1571		470 (11)	1101		
XXXVII. Currency	20000			20000		
XXXVIII. Mint	10372			10372		
XXXIX. Civil Works	4032			4032		
XLIV. Receipts in aid of Supp. annu- ation	123		123			
XLV. Stationary & Printing	689				689 (12)	
XLVI. Miscellane- ous	13972		1100 (13)	12744		128 (14)
XLVII. Defence Services	37400			37400 (15)		
LI. Extraor- dinary receipts	3283	1783 (16)	400 (17)			1100 (18)
Totals	1190230-	857740-	15749-	207798-	105214-	3729

Total current receipts in the General Govt. Acc. = (1)-(5)-(6) = 1081287.

7. Sale of unclaimed & escheated property; 8. Contributions from Municipalities (5104) & Transfer from fund for social Uplift Schemes (3965); 9. Transfer from the fund for S.U. Schemes; 10. Contributions from provinces & States; 11. Transfer from the fund for S.U. Schemes; 12. Sale of Government publications; 13. Transfer from fund for S.U.S.; 14. Sale of stores; 15. Sale of obsolete stores & Recoveries on account of stores issued on payment a part of this may be receipts from the capital account of the payers, but this could not be separated; (contd).

Expenditures:

Heads	Total	Economic Payments	Transfer Payments	Payments of Enter-prises	Capital payments
	(1)	(2)	(3)	(4)	(5) (19)
1. Cabinet	5350	5349			1
2. Other Exp. of Cabinet Secretariat	50		50		
3. Ministry of Commerce	4099	4099			
4. Ports & Pilotage	531	531			
5. Lighthouses & L-ships	220	220			
6. Commercial Intelligence	399	399			
7. Other exp of Ministry of Commerce.	959	959			
8. Min. of Communications	334	334			
9. Pak Railways (20)					
10. Posts & Telegraphs (21)					
11. Central Road Fund	9000		9000		
12. Other exp of Min. of Communications	1344	1234			110
Constituent Assembly	939	939			
13. Min. of Defence	1071	1071			
14. Meteorology	4199	3709			490
15. Aviation	14001	5845	5737		2419
16. Defence Services	711500	711500			
17. Min. of Ec. Affairs	2844	2844			
18. Tech. Assistance & Economic aid	7868	672	7196		
19. Min. of Education	1206	1206			
20. Archeology & Museums	941	837	1		103
21. Education	11326	2317	9009		
22. Min. of Finance	4572	4572			
23. Customs	12196	11705	2		489
24. Central Excise & Salt	11818	7667	100	4051	
25. Taxes on Income, Corp'n & Sales tax	5148	5148			
26. Other exp on collection of revenue	1696	144		1552	
27. Audit & Mint	10757	10757			
28. Currency & Mint	3700	3700			
29. Superannuation Allowances & Pensions	5081		5081		
30. Grants-in-aid & Misc. Adjustments between Central & Prov Govts	12528	28	12500		

16. Levy on imported cotton cloth; 17. Rebate from the Attock oil Co.;
 18. Sale of Land; 19. Unless otherwise stated, this column represents expenditures on works, plants, machinery and stores.

Heads	(1)	(2)	(3)	(4)	(5)
31. Other exp of Min.of Finance	1502	1332	170		
Debt Services	94958	74958			20000 (20)
32. Min. of Food & Agrlture	2333	2333			
33. Forest	412	392			20
34. Survey of Pakistan	1418	1418			
35. Bot & Zoological Survey Department	198	198			
36. Agr., Veterinery & Cooperation	5117	3301	1693		123
37. Fisheries	336	336			
38. Min. of Foreign Affairs & Commonwealth Relation -s	2954	2952			2
39. Foreign Affairs	22324	19706	2618		
40. Other exp of Min. F.A.C.R.	450	350	100		
Staff of Governor General	3324	3314			1 0
41. Min of Health & Works	494	494			
42. Medical Services	9437	7929	1508		
43. Public Health	1827	1557	270		
44. Civil Works	9209	5214			3995
45. Other exp of Min.of Health & Works	345	335	10		
46. Min. of Industries	4511	4511			
47. Irrigation, Navigation, Embankment & Drainage Works	838			838	
48. Geological Survey	620	620			
49. Industries	589	569	20		
50. Dept of Supplies & Development	8198	8068			130
51. Stationary & Printing	3193			3193	
52. Other exp of Min. of Industries	512	512			
53. Min of Information & Broadcasting	4840	4840			
54. Pak Broadcasting Service	7001	6656			345
55. Other exp of Min. of Information & Broadtng	151	151			
56. Ministry of Interior	1003	1003			
57. Police	11547	11547			
58. Civil Defence	303	303			
59. Karachi	32829	24590	8239		
60. Other exp of Min.of Interior.	110	46	64		
61. Min. of Kashmere Affairs	1083	1083			
62. Exp connected with Kashmere Refugees	7785	7785			
63. Min. of Labour	861	861			
64. Other exp of Min of Lab.	2360	1792	568		
65. Ministry of Law	545	545	56		

20. Appropriation for reduction or avoidance of ~~the~~ debt, which has been shown in the cap account as a capital transfer from the general accoun-
-t to the fund for redemption of debt and as a capital receipt of the

Heads	(1)	(2)	(3)	(4)	(5)
66. Administration of Justice	690	690			
67. Min. of Parliamentary Affairs	66	66			
Pak Public Service Commission	569	569			
68. Min. of Refugees & Rehabilitation	802	802			
69. Rehabilitation of Refugee & Protection of Evacuee Property	23056	4566	18500		
70. Min. of Frontier Regions	452	452			
71. Frontier Regions	68960	66102	310		2548
72. Baluchistan	18094	17097	414		583
Totals	1203883	-1079721	83160	- 9634	- 31368

Current expenditures shown as capital outlays in the budget (vide capital expenditure account, column 5):

76. Ports	50	50	
78. Defence	21000	21000	
80. Pensions	1155		1155

Grand totals	1226088	-1100771	84315	9634	- 31368
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Total current expenditures from the General Government Account = (1) - (4) - (5) = 1185086.

(b) Enterprise Account:

Enterprises	Receipts (incomes)	Payments (economic)
Salt	2300	3551
Opium	851	1552
Railways (net)	91000	-
Posts and Telegraphs	10000	-
Irrigation, Navigation & Embankment	374	77
Stationary and Printing	689	2986
State Trading (net)	-	22411
Totals	105214	30577

Funds	Receipts (transfers)	Payments (economic)	do. (transfers)
Railway Improvement Fund	7500		
Central Road Fund	9000	2616 (21)	
Coal Mines Labour Welfare Fund	420		
Special Fund for Rehabilitation of Refugees	18500		
Posts and Telegraphs Welfare Fund	150		
Fund for Scientific & Industrial Research		6050 (22)	
Fund for Educational & Economic Uplift of Scheduled Castes		150 (23)	
Fund for Social Uplift Schemes			9500 (24)
Fund for Agricultural Development		2057 (25)	
Fund for Glaser Inter-Provincial Contacts		1800 (26)	
Fund for Overseas Scholarship Schemes		448 (27)	
Fund for Development of Urdu		100 (28)	
Totals	35570	13221	9500
	total current expenditures -		22721

21. Vide Demand for Grant No.11. 22. do, no.49; 23. do, no. 21;
24. Explanatory Memorandum, p.89, transfers from the fund to the
centrally administered areas-i.e, to the current account of the
Govt. budget. 25. Demands for Grants, nos. 32,36,37,72; 26. do, no.2;
27. do, no. 21; 28. do, no. 21;

Capital Account -- Receipts:

Items	Total	Borrowings	Other Capital Receipts
Permanent debt-internal (net)	150000	150000	
Do-external (net)	54415	54415	
Treasury Bills & Other Floating debts	201187	201187	
Unfunded debt (net)	78993	78993	
Foreign aid Fund	632304		632304
Recoveries of loans and Advances	43297		43297
Miscellaneous Capital Receipts	39923		39923
Deposits and Remittance transactions (net)			
Provisions for depreciation & renewals of Railways, Post & Telegraphs, Salt and Printing Press	36007		36007
Capital receipts treated as current receipts in the budget (vide current acc.col6)	3729		3729
Appropriation for Reduction of debt	20000		20000
total	1237482	462222	775260

Capital Account--Expenditures: Dhaka University Institutional Repository

Heads	total (1)	real in- vestment (2)	financial investt (3)	Indirect Investt (4)	Current expend. (5)
74. Railways	145000			145000	
75. Posts and Telegraphs	37368			37368	
76. Ports	2963	2701	212		50(29)
77. Civil Aviation	8300	3300	5000		
78. Defence	88500	67500			21000(30)
79. Mint	71	71			
80. Pensions	1155				1155(31)
81. Misc. Dev. projects	18729	7729	11000		
82. Forests, Agr. improve- ments and research	20948	816	20132		
84. New Federal Capital	1908	1718	190		
85. Civil Works	72183	71291	892		
87. Industrial Develop- ment	162911	162911			
88. Irrigation, Fuel & Power	45444	39167	1792	4485	
89. Printing press	2362			2362	
91. Broadcasting Service	1500	1500			
92. Loans & Advances	500888			500888	
TOTALS	1110230	358704	39218	690103	22205

Capital expenditures
Shown as current in
the budget(current acc.
column 5 & part of
Column 4):

24. Salt	500			500	
25. Irrigation	761			761	
51. Stationary & Printing	207			207	
1. Cabinet	1	1			
12. Other exp of Min.of Communications	110		110		
14. Meteorology	490	490			
15. Aviation	2419	2169	250		
20. Archeology & Musenms	103	103			
23. Customs	489	4	485		
33. Forest	20	20			
36. Agr., Vet & Cooperat- ion	123	123			
38. Min.of F.A.C.R.	2	2			
44. Civil Works	3995	3971	24		
50. Dept of Supply & Dev.	130	130			
54. Pak Broadcasting Service	345	145	200		
71. Frontier Regions	2548	2394	154		
72. Baluchistan	583	583			
Appropriation for reduction of debt	20000			20000	
Expenditure from Funds	110938	110938(32)			
Grand totals	1254004	479787	40441	711571	22205

Total capital expenditures----- (1) - (5) = 1231799

Summary Accounts:

Dhaka University Institutional Repository

Current Receipts:

(in thousands of Rupees)

Account	total	tax-revenue	non-tax transfers	incomes
General Government	1081287	857740	15749	207798
Enterprise	105214			105214
Fund	35570		35570	
total	1222071	857740	51319	313012

Current expenditures:

Account	total	economic payments	transfer payments	balance
General Government	1185086	1100771	84315	-103799
Enterprise	30577	30577		74637
Fund	22721	13221	9500	12849
total	1238384	1144569	129315	16313(33)

Capital Account:Receipts:

borrowings
non-borrowings

462222
755260

Expenditures:

real inv 444287
financial investmt 40441
indirect investmt 711571

5683

total cap.R:

1237482, Cap E: 1231199

Total Receipts-

2459553; Total Exp.2470183

Net balance met by drawal on cash balance -----

10630.

29. Provision for emigrant expenses; 30. Defence outlays on plant & Machinery; 31. Payment of commuted value of pensions; 32. Part of Expenditure met from funds has been absorbed under the other heads of capital expenditure, and amounts to 120169 thousands of Rupees; the item under consideration is the unexplained portion of the total disbursements from the funds which has been assumed to be real capital expenditure (133659 - 22721 = 110938);
33. Against this figure of current deficit, the budget statement shows a deficit of 13653 thousands in the current account.

Note to the appendix
Revised calculation of the current balance in accordance with
the treatment in the draft five-year plan

Current or revenue receipts:

Since the plan has treated all taxes, including estate duties, as revenue receipts, the total revenue receipts according to it will not be Rs 1222071,000 as shown in our reclassified accounts, but will be Rs 1222071,000 plus 2500,000 (estate duty), or

1224571,000

Current or non-development expenditures:

First, "the development outlays embraced by the plan are not confined to investment in fixed capital, but includes outlays on certain new or expanded schemes in the fields of education, health, Village AID and other social services which,serve to increase the community's intangible productive capital, by raising the fitness and skill of the people."

Second, the plan treats savings as a gross concept and not net, so that provisions for depreciation and renewals of capital, and other expenditures on repairs etc. are not charged against saving.

Total Current or non-development expenditure in accordance with the plan, therefore, will not be Rs 1238384,000 as shown in our reclassified accounts; instead, the following items have to be deducted from this total:

(in ,000)		
Demand no 21	--scholarships for education ---	439
" 42	-- " medical edn --	38
"	-- training of medical graduates and nurses -----	279
" 59	--stipends to trainee teachers--	180
"	--scholarships -----	40
"	--Lump sum provisions for schemes financed from the fund for Social Uplift Schemes:	
"	" --Education -----	2975
"	" -- Medical -----	2975
" 72	-- Baluchistan ----	990

Demand no --	(in ,000)	
72	Scholarships -----	67
"	Lump sum provision for expansion of education in Baluchistan --	100
21	Expenditures from the fund for Overseas scholarship schemes --	448
		/5556/
17	Lump sum provision for V-AID---	102
72	V-AID programme in Baluchistan--	1043
		/2045/

Expenditures on repairs and replacements etc:

12	Ports and Pilotage -----	682
15	Aviation -----	913
		549
		4
24	Salt -----	42
		35
44	Civil Works -----	3971
		150
47	Irrigation -----	24
		100
		50
		27
71	Frontier Regions -----	5971
		2233
		672
		950
		/16193/

Provisions for depreciation & Renewals of
Railways, Posts and Telegraphs, Salt and
Printing Press -----

/36007/

Total deductions ----- 59801

Total non-revenue expenditures --- 1238384 - 59801 = 1178583

current balance (gross saving) --- 1224571 - 1178583 = 45988

net saving ---- 45988 - 52200* = - 6212

*16193 plus 36007.