CHAPTER 5: GOVERNMENT BUDGET

Government budget is a statement of the estimates of the government's expected receipts and government's expected expenditure during the financial year or fiscal year which runs from 1st April to 31st March.

In India**, Article 112** of the Constitution requires the Central Government to prepare '**Annual Financial Statement'** for the country as a whole. This is called '**Budget of the Central Government'**. **Article 202** of the Constitution requires every State Government to prepare **'Annual Financial Statement'** for the concerned state. This is called **'Budget of the State Government'.**

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Introduction of Government Budget and the Economy

A government budget is made to approach and address the needs and issues of a country. It is an annual financial statement where an itemized estimate of revenue expected and expenditure anticipated are listed for the current fiscal year which runs from April 1 of one year to March 31 of the next year.

The basic elements of a government budget are as follows:

- **Public Expenditure:** A national budget authorizes public expenditures under two categories:

  Government purchase of goods and services to serve the public with services like health care, education, defence, etc.
  Payment of social security and other such transfers to individuals and offering subsidies payment to industries and commercial companies.

- **Revenues:** government finds ways and means to earn revenue to meet their expenditure.

- **Actual Receipts and Expenditure List:** When the financial year closes on March 31st, a detailed list of actual revenue and expenditure is provided along with reasons for deficits (or surplus) that have occurred during that financial year.

- **Economics Government Budget:** The financial policy for the coming fiscal year is disclosed, which include taxation proposals, spending programs, revenue prospects, and the introduction of new schemes or projects.

Public Goods

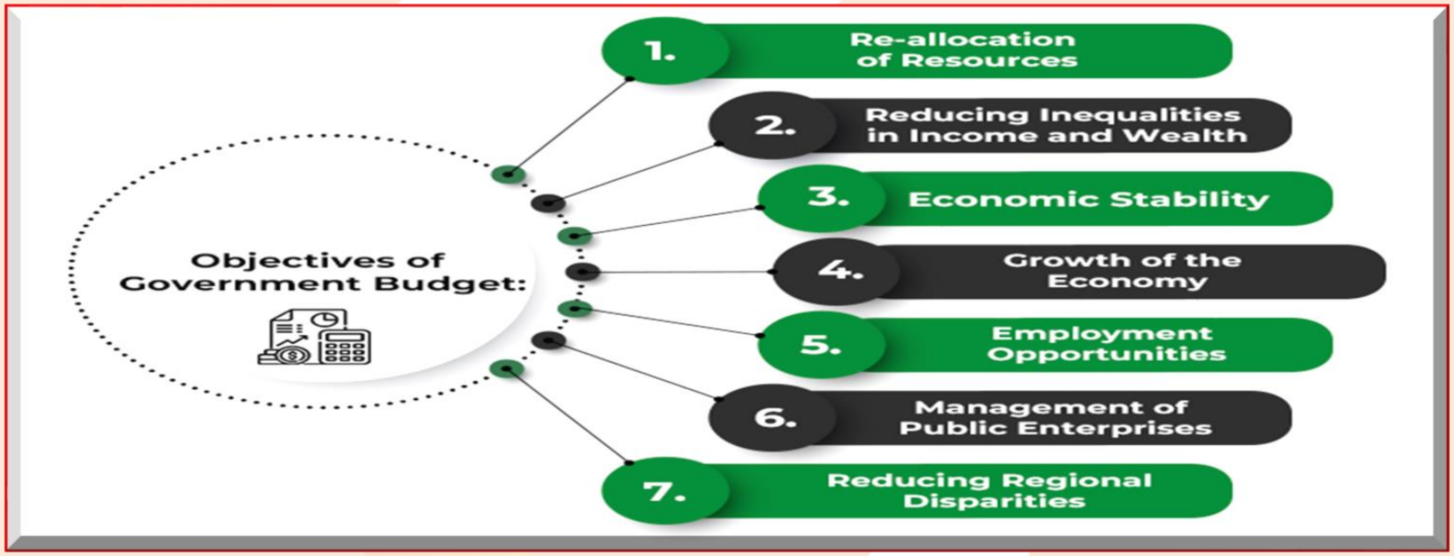
The goods which cannot be provided through the market mechanism and hence must be provided by the government are called public goods. These goods have two important features of non-rivalrous and non-exclusive in consumption. E.g., roads, public parks, street lighting, etc.

Private Goods

The goods which can be provided through market mechanism, i.e., transactions between individual consumers and producers are termed as private goods. These goods are either rivalrous or exclusive in consumption. E.g., food items, clothes, shoes, etc.

Objectives of Government Budget

Objectives of government budget are as follows:



Re-distribution of Income and Wealth:

Government through fiscal tools of taxation and transfer payments, brings fair distribution of income. Equitable distribution of income and wealth is a way to bring social justice. For this purpose, progressive tax structure is followed In India, in which burden of tax increases with increase in income. It is also known as distribution function

Re-allocation of Resources:

The government of a country, through its budgetary policy, directs the allocation of resources in a manner such that there is a balance between the goals of profit maximization and social welfare. E.g. there should be production of necessity goods as well as comfort and luxury goods.

Management of Public Goods:

The goods which cannot be provided through market mechanism and hence must be provided by the government are called public goods. E.g., roads, parks, street lights, etc. These goods have two distinct features, as that of:

(a) Non-rivalrous It means consumption by one individual not reduce the amount available for the others.

(b) Non-excludable It means that once a public good is provided, then no one can be excluded from its consumption. These goods promote social welfare.

Economic Growth:

The growth rate of a country depends on the rate of savings and investment Therefore, the roles that are assigned to budgetary policy in this regard are to create conditions conducive for increase in savings and investment.

Generation of Employment:

Government needs to promote labour intensive technology, public works programs like construction of roads, dams, canals, bridges, etc. to promote employment generation in the economy. Several programs are initiated through budget to reduce the problem of poverty and unemployment.

Economic Stability:

Government tries to establish economic stability by its budgetary policies. Economic stability refers to a situation without fluctuations in price levels and stability of exchange rate in an economy. Economic stability is achieved by protecting the economy from harmful effects of various trade cycles and its phases, i.e., boom, recession, depression and recovery.

Management of public enterprises:

Public sector enterprises are owned and governed by the government and through budgetary policy, it tries to manage the expenditure and revenue of PSUs.

Impacts of Budget

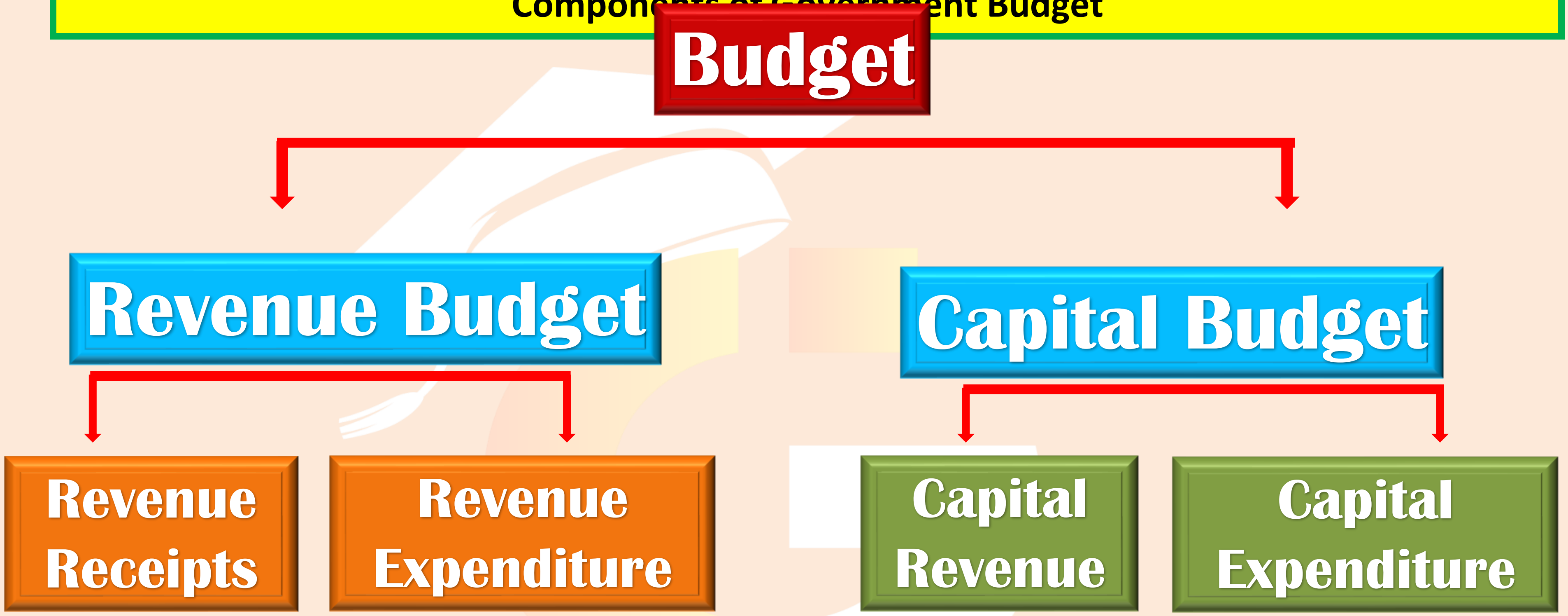
Budget impacts an economy at three levels:

(i) It brings aggregate fiscal discipline level, i.e., budget tries to maintain an ideal balance between revenues And Expenditures of the government.

(ii) It brings better allocation of resources, i.e. government, through its budget, will allocate resources to those areas where it is Socially desirable.

(iii) Through budget, government can effectively and efficiently plan and implement its social welfare programs.

Components of Government Budget

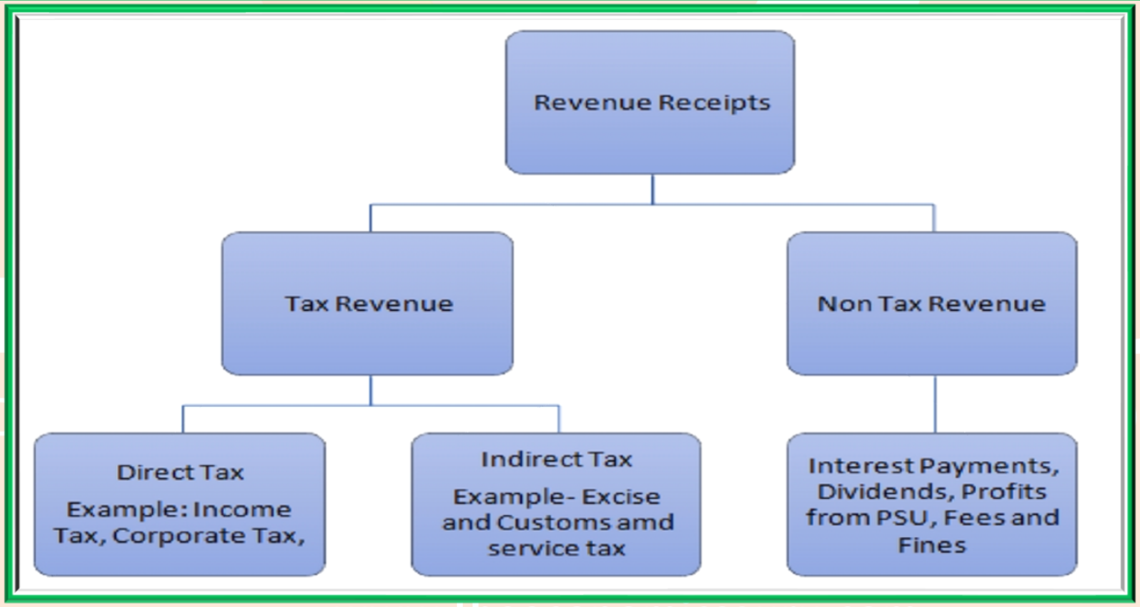


Revenue Budget

The revenue budget shows the current receipts of the government and the expenditure that can be met from these receipts. Revenue budget is the statement of estimated revenue receipts and estimated revenue expenditure during a fiscal year.

Revenue Receipts

Receipts which do not create a liability for the government or do not lead to reduction in assets, are known as revenue receipts. Revenue receipts are receipts of the government which are non- redeemable, i.e., they cannot be reclaimed from the government. These are divided into tax and non-tax revenues:



Tax Revenue:

What is tax?

A tax is a legally compulsory payment imposed by the government on the households and producers. Progressive tax It is a tax that causes relatively less burden on the poor and more on the rich, i.e., tax rate rises with rise in Income.

It consists of the proceeds of taxes and other duties levied by the Central Government. Tax revenues comprise of direct taxes and indirect taxes:

- **Direct tax:** It is a tax levied on households and firms and its final burden cannot be shifted on to others, e.g. income tax, wealth tax and corporation tax.
- **Indirect tax:** It is a tax levied on goods and services and its final burden can be shifted on to others, e.g. excise tax, VAT, entertainment tax.

Regressive tax

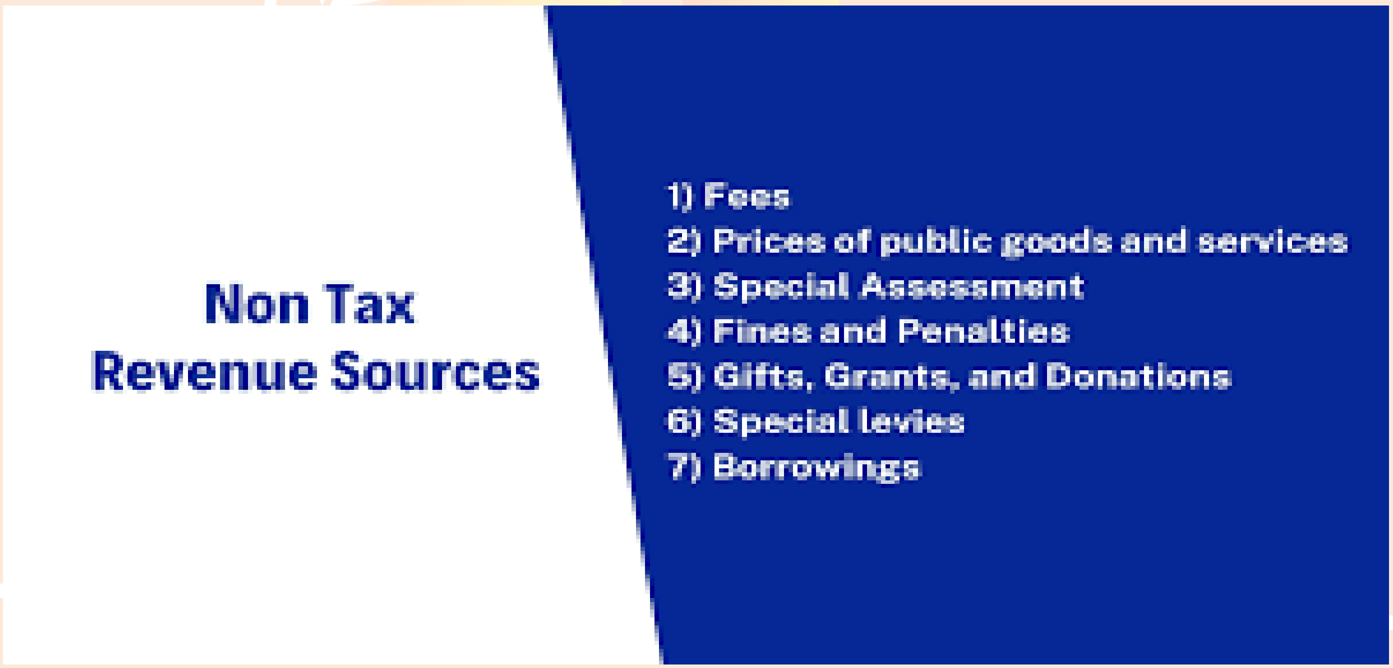
It is a tax that causes relatively more burden on the poor and less on the rich, i.e., tax rate falls with rise in income.

Proportional tax

It is a tax in which the rate of taxation remains constant with increase or decrease in income. Lump sum taxes These are the taxes that do not depend on Income.

Non Tax Receipts

Non-tax revenue of the Central Government mainly consists of interest receipts on account of loans by the Central Government, dividends and profits on investments made by the government, fees and other receipts for services rendered by the government. Cash grants-in-aid from foreign countries and international organisations are also included in non-tax revenue.



Revenue expenditure

These are those expenditures which

- **Neither create any asset**
- **Nor reduce liabilities of the government.**

These expenditures are incurred for smooth functioning of government departments and for day-to-day expenses of the government. E.g., salaries, pensions, interest payments, subsidies, grants, etc. Revenue expenditure is classified into plan and non-plan expenditure:

Plan Revenue Expenditure

It relates to central plans (the Five-Year Plans) and central assistance for state and union territory plans. E.g., expenditure on health, education, law and order, etc.

Non-plan Revenue Expenditure

It covers a vast range of general, economic and social services of the government. E.g., expenditure as a relief to earthquake victims, etc.

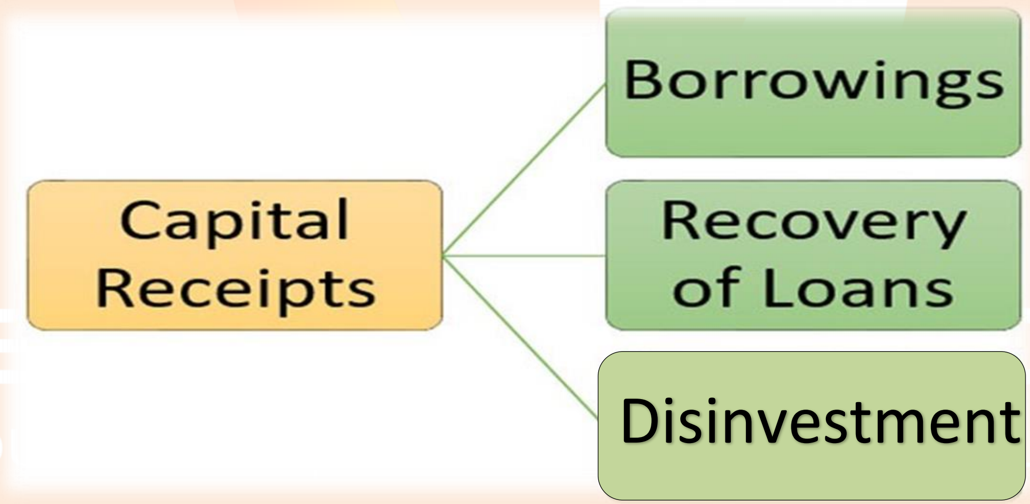
Capital budget

The capital budget is an account of the assets as well as the liabilities of the Central Government, which takes into consideration changes in capital.

It consists of capital receipts and its payments. Capital budget is the statement of estimated capital receipts and estimated capital expenditure during a fiscal year.

Capital Receipts

All those receipts of the government which **create liabilities or reduce financial assets**, are termed as capital receipts. Capital receipts are obtained by the government by raising funds through borrowings, recoveries of loans and disposing of assets.



Disinvestment

It refers withdrawal of the existing investment. E.g., the Government of India is undertaking disinvestment by selling its shares in the Maruti Udyog. It is a capital receipt of the government, as it reduces assets of the government.

Borrowings

It creates liability for the government. Accordingly, borrowings are to be treated as capital receipts. It is a debt creating capital receipt.

Recovery of Loans

Government recovers loans lend to states or other countries. It reduce the government Assets

Capital Expenditure

Capital expenditure are the expenditures of the government which result in **creation of physical or financial assets or reduction in financial liabilities.**
This includes expenditure on the acquisition of land, building, machinery, equipment, investment in shares, loans and advances by the Central Government to state and union territory governments, PSUs and other parties.

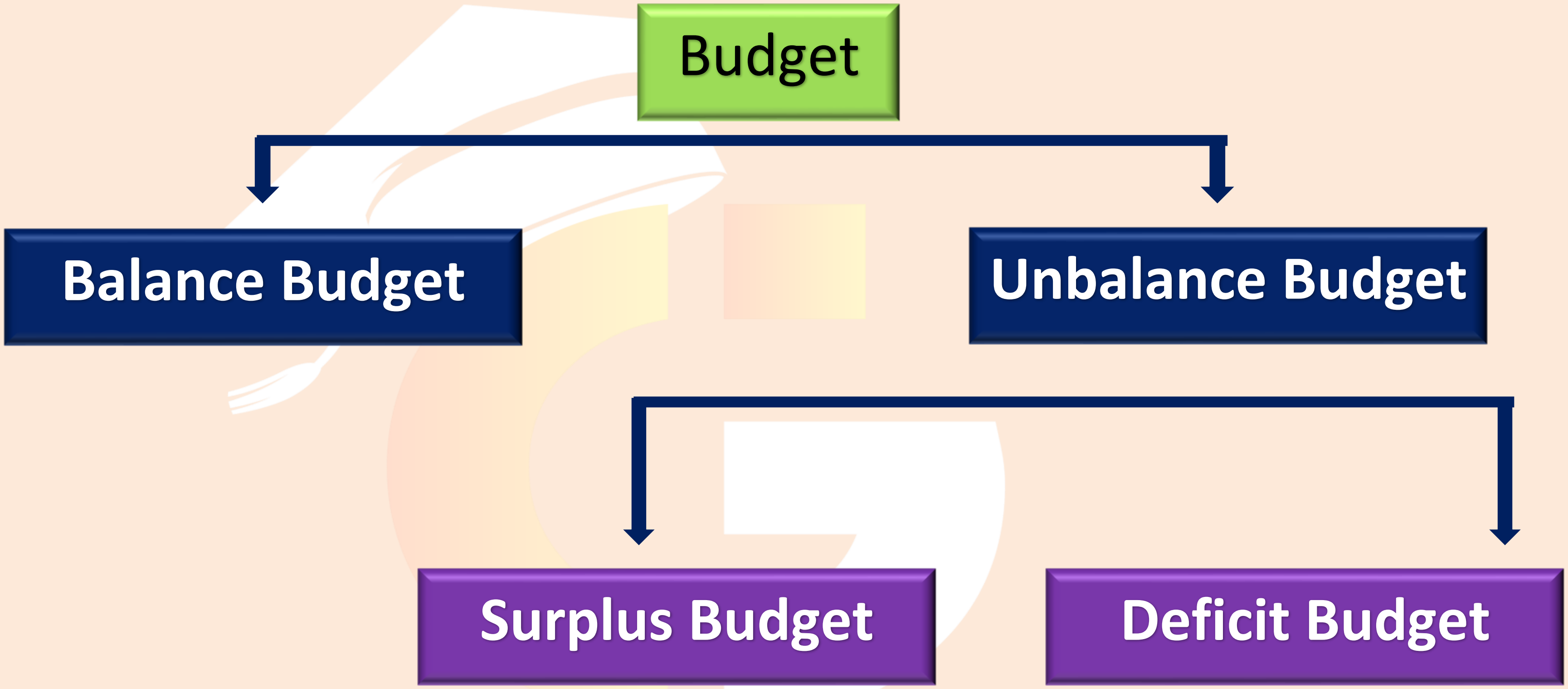
It is also categorized as plan and non-plan expenditure in the budget documents:

- **Plan capital expenditure It is related to the Five-Year Plans and central assistance for state and union territory plans.**
- **Non-plan capital expenditure It refers to the expenditure which is not related to Five Year plans. It covers various general, social and economic services provided by the government. E.g., expenditure as a relief to the earthquake victims.**

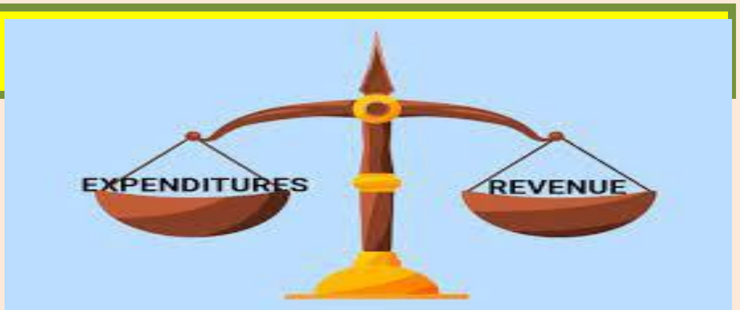
Differences between Revenue and Capital Expenditure

Basic	Revenue expenditure	Capital expenditure
Meaning	These are those expenditure of government which neither cause increase in government assets nor cause any reduction in government liabilities	It Is the expenditure of government which leads to either increase in government assets or reduction in government liabilities.
Purpose	It Is spent on normal functioning of government departments and various provisions.	It is spent on acquisition of assets, repayment of borrowings and granting of loans and advances.
Nature	It is a recurring expenditure	It is non-recurring expenditure.
Example	Expenditure on old age pensions, expense on administrative services, expense on national security, expense on health and education, etc.	Expenditure on the construction of national highways, repayment of government loans, establishment of factories, etc.

TYPES OF BUDGETS



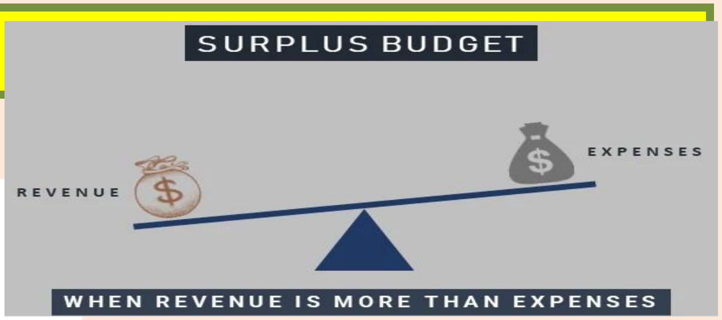
(i) Balanced Budget



It is that budget in which government's estimated revenues are equal to government's estimated expenditures.

Total Receipts = Total Expenditure

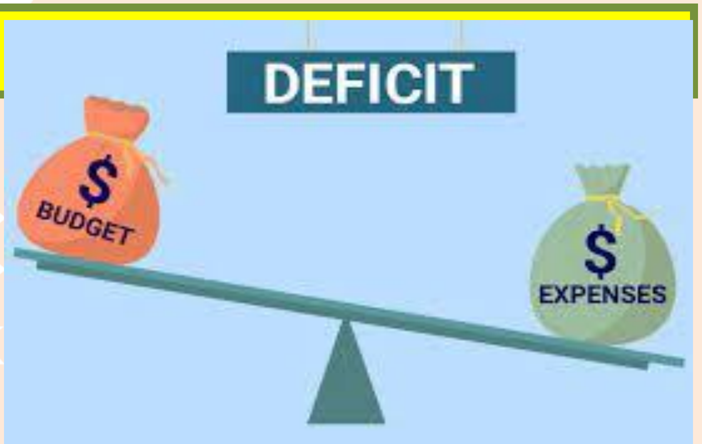
(ii) Surplus Budget



It is that budget in which government's estimated revenues are more than government's estimated expenditures.

Total Receipts > Total Expenditure

(iii) Deficit Budget



It is that budget in which government's estimated revenues are less than government's estimated expenditure. It is a good policy to control recession.

Total Receipts < Total Expenditure

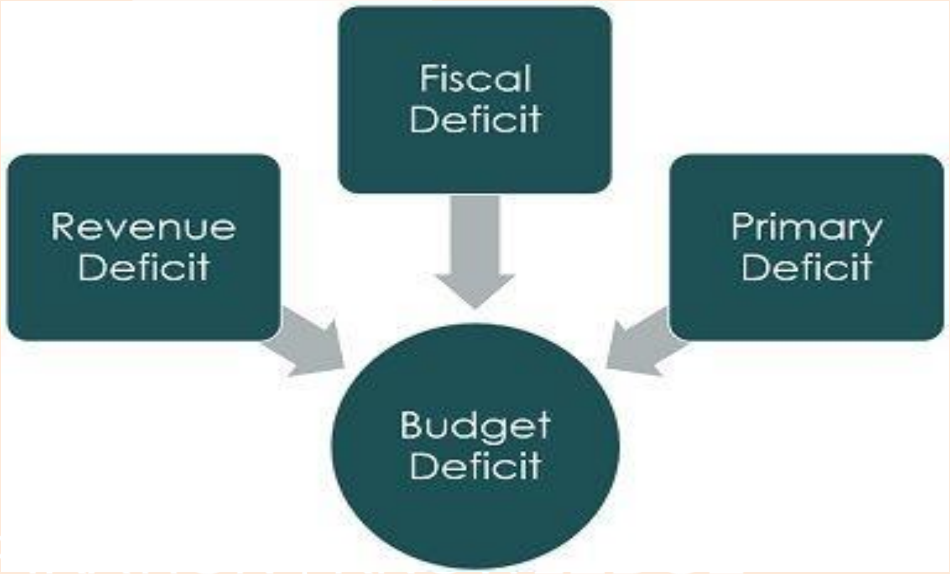
Budget Deficit

When government spends more than what it collects by of revenue, it incurs a budget deficit. Budget deficit or a situation when budget way government deficit refers to expenditures of the government are greater than the government receipts.

To meet the deficit, government rely on borrowings that give rise to debt.

Measures of Budget Deficit

There are three measures of budget deficit and they have their own à implications for the economy.



Revenue Deficit

It is defined as the excess of government's revenue expenditure over revenue receipts. The revenue deficit includes only such transactions that affect the current income and expenditure of the government.

Revenue Deficit = Revenue Expenditure – Revenue Receipts

Where, Revenue Expenditure (RE) – Interest Payments + Non-interest Expenditure

or

Plan Expenditure + Non-plan Expenditure Revenue Receipts (RR) Tax Revenue + Non-tax Revenue

Implications of Revenue Deficit

- Current expenditures. In developing countries like India, often the situation arises when the government has to incur huge expenditure on
- High revenue deficit gives a warning to the government either to cut its expenditure or increase its revenues. It shows the inefficiency of the government to meet it.
- Administration and maintenance and it is difficult to force
- The people to pay high taxation. This situation means that the government will have to borrow not only to finance its investment but also for its consumption

requirements. This will lead to build up stock of debt and interest liabilities and force the government, eventually, to cut expenditure.

- Since, a major part of revenue expenditure is committed expenditure, it cannot be reduced. Often the government reduces productive capital expenditure or welfare expenditure. This would mean lower growth and adverse welfare implications.

Fiscal Deficit

Fiscal deficit is the difference between the government's total expenditure and total receipts, excluding borrowings. It is calculated as:

Fiscal Deficit = Total Budget Expenditure – Total Budget Receipts (Excluding borrowings) or Fiscal Deficit

= Total Budget Expenditure – (Revenue Receipts + Non-debt Creating Capital Receipts)

Non-debt creating capital receipts are those receipts which are not borrowings and therefore, do not give rise to debt. Revenue deficit is a part of fiscal deficit, so fiscal deficit can also be calculated as:

Fiscal Deficit = Revenue Deficit + Capital Expenditure – Non-debt Creating Capital Receipts or Fiscal Deficit = Borrowings

Implications of fiscal deficit are as under:

- It determines total borrowing requirements of the government.
- It is always injurious to the economy and leads to financial unsoundness.
- Repayment of loan together with interest further increases fiscal deficit, which creates debt trap.
- It increases the liability of the government. (v) It increases foreign dependence.

Primary Deficit

Primary deficit is equal to fiscal deficit reduced by

It is calculated as:

Interest payments. Primary Deficit = Fiscal Deficit – Interest Payments

Note Zero primary deficit means that the government has to resort to borrowings only to make interest payments.

Implications of Primary Deficit

It indicates borrowing requirements of the

Government to meet fiscal deficit net of interest payments. It enables us to see the way, how the government is currently conducting its financial affairs.