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GOVERNMENT AND THE BUDGET

In India, government budget is normally presented in the Parliament in the month of February every year. Before the budget is presented, for many days there are speculations among people about the expected changes in various taxes. Are the rates of income tax going to be increased or decreased? Whether the price of petrol and cooking gas cylinders going to be left unchanged? All of us discuss these expected changes in budget because they affect our future expenditure on goods and services. However, this may give an impression that government budget is merely an exercise concerned with various taxes. But, in fact, government budget is much more than changes in taxes.

This lesson describes the structure of government budget and its objectives. In this lesson, you will learn about government budget and realize that it is more than mere changes in tax rates.

OBJECTIVES

After completing this lesson, you will be able to:

- understand the meaning of government budget;
- draw the structure of government budget;
- differentiate between revenue and capital receipts;
- differentiate between revenue and capital expenditure;
- differentiate between plan and non-plan expenditure;
- understand the meaning of revenue deficit, fiscal deficit and primary deficit;

- understand the ways to finance various deficits; and
- understand the meaning and objectives of budgetary policy.

29.1 WHAT IS GOVERNMENT BUDGET?

The budget of a government is a summary of the itemwise intended/expected revenues and anticipated expenditures of the government during a fiscal year/ financial year. In India the financial year spans from 1st April to 31st March over two calender years.

Government at all levels, whether central, state or a local level, prepare the budget. Budget is prepared, keeping in view the general policy of government towards the welfare of people.

Government incurs various expenditures to provide basic facilities such as education, health, etc. It also spends money to increase production, to reduce unemployment, poverty and inequalities in income and wealth etc. Such expenditure of government promotes welfare of the people. To finance this expenditure, government raises revenue from sources such as taxes, public debt, etc. These financial resources that fund government expenditure are raised from people.

The items of expenditure and the sources of financing them are planned by government in accordance with the objective of public welfare. Thus, government takes decisions on behalf of people with respect to how public money is to be spent under different heads of expenditures and how it is to be raised from various sources. This makes government accountable to people. Through legislatures, parliament and various other civic bodies, people exercise their right to know as to how government is spending public money and how it is raising it from them. This accountability of government to the people of the country is manifested in the government budget. **A budget is a consolidated financial statement prepared by government on expected public expenditure and public revenue during a financial year.**

There are three main features of a government budget. **One,** it is a consolidated financial statement of expected expenditures and various sources of revenue of government. **Two**, it relates to a financial year. And **three,** the expenditures and the sources of revenue are planned in accordance with the declared policy objectives of government.

29.2 STRUCTURE OF BUDGET

To understand the basic structure of budget and its various components, let us consider the budget of the Central Government of India for the financial years 2012-13 presented in **Table 29.1.** From this Table we find that the budget has two parts:

(1) **Receipts and** (2) **Expenditures.**

Table 29.1 : Central Budget: Receipts and Expenditures of the Central Government (Rs. Crores)

		2012-2013 Actuals
1.	**Revenue Receipts**	**877613**
	2. Tax Revenue (net to centre)	740256
	3. Non-Tax Revenue	137357
4.	**Capital Receipts (5+6+7)**	**532754**
	5. Recoveries of Loans	16267
	6. Other Receipts	25890
	7. Borrowings and other liabilities	490597
8.	**Total Receipts (1+4)**	**1410367**
9.	**Non-Plan Expenditure**	**996742**
	10. On Revenue Account of which	914301
	11. Interest Payments	313169
	12. On Capital Account	82441
13.	**Plan Expenditure**	**413625**
	14. On Revenue Account	329208
	15. On Capital Account	84417
16.	**Total Expenditure (9+13)**	**1410367**
	17. Revenue Expenditure (10+14)	1243509
	18. Of Which, Grants for creation of Capital Assets	115513
	19. Capital Expenditure (12+15)	166858
20.	**Revenue Deficit (17-1)**	**365896**
		(3.6)
21.	**Effective Revenue**	**250383**
	Deficit (20-18)	(2.5
22.	**Fiscal Deficit**	**490597**
	(16-(1+5+6)}	(4.9)
23.	**Primary Deficit (22-11)**	**177428**
		(1.8)

(1) Receipts

The receipts of government show the different sources from which government raises revenue. These receipts are of **two** kinds: (i) **Revenue receipts** and (ii) **Capital receipts.**

Revenue receipts are current income receipts from all sources such as taxes, profits of public enterprises, grants, etc. Revenue receipts neither create any liability nor cause any reduction in the assets of the government. Capital receipts, on the other hand, are the receipts of the government which either create liability or cause any reduciton in the assets of the government. e.g. borrowings, recovery of loan and disinvestment etc.

It must be mentioned here that there is a similarity between the financing by an individual and the financing by a government. An individual, generally, finances his current expenditure from his current income. He borrows when his current income is not sufficient for his current expenditure. Likewise, a government has two sources to finance its expenditures: current income or revenue receipts and capital receipts. It borrows when revenue receipts fall short of its current expenditures. The dissimilarity between financing by an individual and that by a government is that an individual first estimates his current income and then plans his expenditures while a government plans its expenditures first and then finds the sources to finance them.

(1) Revenue Receipts

Revenue receipts are current incomes of government, which neither create liabilities nor cause any reduction in the assets of the government. These receipts are classified into (a) **Tax Revenue** and (b) **Non-tax Revenue.**

(a) Tax Revenue : A tax is a legal compulsory payment by the people and firms to the government of a country without reference to any direct benifit in return.. It is imposed on the people by the government. A government collects revenue from various taxes like income tax, sales tax, service tax, excise duty, custom duty etc. *Traditionally the revenue from taxes has been the primary source of government income.*

Income tax is imposed on those who earn income such as wages, salaries, rent, interest and profit. Sales tax is the tax on the sale of goods. Whenever we purchase a good, a part of our payment goes to the government as sales tax. Service tax is the tax we pay when we use a service such as telephone service. Excise duty is a tax paid by the producer manufacturing a good. Custom duty is paid when a good is imported or exported.

All taxes are of two kinds: (a) Direct taxes and (b) Indirect Taxes. This distinction between taxes depends on (1) the liability of payment of tax to government and (2) the actual burden of tax.

In case of *direct taxes,* the liability of payment and the burden of the tax falls on the same person. For example, income tax is a direct tax because the person who is liable to pay it also bears the burden of the tax; The burden of the tax cannot be shifted on others. But this does not happen in case of *indirect taxes.* For example,

in case of sales tax, although the liability to pay tax lies with the seller of a good, the actual burden of tax falls on the buyer. The buyer and not the seller is the one who finally pays the sales tax. The seller only collects the tax from the buyer by increasing the price and pays it to the government. Thus, we find that incase of sales tax, the burden of tax is shifted from the seller to the buyer. All taxes on production are indirect taxes because producers recover these taxes from buyers by increasing the price of the product.

Example of Direct Taxes

- Income tax: the tax on incomes of individuals
- Corporation tax : the tax on corporate profits
- Wealth tax: the tax on wealth of individuals
- Gift tax: the tax on gifts given

Example of Indirect Taxes

- Value added tax
- Excise duty: the tax on goods manufactured in factories
- Customs duty: the tax on imports and exports
- Service tax: the tax on the services provided

Difference between Direct Taxes and Indirect Taxes

S.No.	Basis	Direct taxes	Indirect taxes
1.	Impact	Direct taxes are levied on individuals and firms	Indirect taxes are levied on goods and services
2.	Shift of burden	The burden of a direct tax cannot be shifted, i.e. impact and incidence are on the same person	The burden of an indirect can be shifted, i.e. impact and incidence are on different persons e.g. a seller can increase the price of the good after tax is imposed so that the buyer will bear the burden of the tax.
3.	Nature	They are generally progressive in nature	They are generally proportionate in nature
4.	Coverage	They have limited reach as they do not reach all the sections of the society	They have a wide coverage as they affect all the sections of the society

(b) Non-Tax Revenue

The incomes accruing to government from sources other than taxes are *non-tax revenues*. The major sources of non-tax revenues of the central government of India are:

(i) **Commercial Revenue:** It is received by government in the form of prices paid by people for goods and services that government provides e.g. people pay for electricity and for services of Railways, postal stamps, toll etc.

(ii) **Administrative Revenue:** It arises on account of administrative services of the government. They are as follow:

(a) fees in the form of passport fees, government hospital fees, education fees, court fee, etc.

(b) fine and penalites: charged by government on law-breakers for disobeying rules and regulations.

(c) licence fee and permit

(d) Escheat : Income that government get by taking possession of property which has no legal claimant or legal heir.

(e) Interest receipts

(f) profits of public sector undertakings.

1. Capital Receipts

As stated earlier, capital receipts are those receipts of the government which either create liability or cause any reduction in the assets of the government.

The major sources of capital receipts of the central government are: (i) Borrowings (ii) Recovery of Loans and (iii) Disinvestment - Resale of shares of public sector undertakings.

(i) **Borrowings:** There are two sources from which the central government borrows. They are:

(a) **Domestic Borrowings:** The government borrows from domestic financial market by issuing securities and treasury bills. It also borrows from people through various deposit schemes such as Public Provident Fund, Small Savings Schemes, and National Savings Scheme etc. These are borrowings of the government within the country.

(b) **External Borrowings:** In addition to domestic borrowings the government also borrows from foreign governments and international bodies like International Monetary Fund (IMF), World Bank etc. Foreign borrowings by the government bring in foreign exchange into the domestic economy.

Notes

(ii) **Recovery of Loans:** Quite often state and local governments borrow from the central government. The loans recovered by the central government from state and local governments are capital receipts in the budget because recovery of loans reduces debtors (assets).

(iii) **Disinvestment - Resale of shares of public sector undertakings:** This is a very recent source of capital receipts by which the central government has been mobilizing financial resources since 1991. Prior to 1991, the central government owned 100 percent of the shares of public sector undertakings. From 1991, the government adopted the policy of privatisation of public sector undertakings. Consequently, it started selling its shares to general public and to financial institutions. This selling of shares of public sector undertakings by the government is known as **'disinvestment of public sector undertakings'.**

2. Expenditure

Government expenditure is classified in two ways: **capital expenditure and revenue expenditure** and (b) as **plan expenditure** and **non-plan expenditure.**

Capital Expenditure and Revenue Expenditure

When government incurs expenditure to create assets such as school and hospital buildings, roads bridges, canals, railway lines etc., or reduce its liability such as repayment of loan etc., such expenditure is known as **capital expenditure.** But when government incurs expenditure that neither creates any asset nor reduces any liability, such expenditure is known as **revenue expenditure.** For Example, payment of salaries to government employees, maintenance of public property, providing free education and health services to people, etc constitute revenue expenditure. These do not create any public asset.

Plan Expenditure and Non-Plan Expenditure

After independence, our country adopted the path of planning to achieve economic development. Under planning, provisions were made in the government budget for expenditure that was to be incurred every year according to the priorities laid down in the five-year plans. Such expenditure is known as **plan expenditure.**

Beside plan expenditure, government also incurs routine expenditure such as expenditure on police, judiciary, water supply, sanitation and health, legislatures, defence, various government departments, etc. Such routine expenditure is termed as **non-plan expenditure.**

INTEXT QUESTIONS 29.1

Choose the correct alternative.

1. Government budget is a financial statement of
   - (a) Actural expenditure and actual receipts
   - (b) Expected expenditure and expected receipts
   - (c) Expected expenditure
   - (d) Expected receipts
2. Capital Receipts are
   - (a) Taxes
   - (b) Dividends
   - (c) Profits
   - (d) Borrowings, recovery of loans, grants from foreign countries
3. Revenue receipts are
   - (a) Borrowings
   - (b) Revovery of loans
   - (c) Grants from foreign countries
   - (d) Taxes, interest, dividends and profits from public sector undertakings

29.3 BALANCED BUDGET VERSUS DEFICIT BUDGET OR SURPLUS BUDGET

As explained above, government receipt and expenditure are the two components of a budget. In terms of the magnitudes of receipts and expenditure. We may have balance budget, deficit budget and surplus budget.

- When the government expenditure is exactly equal to its receipts, the government has balanced budget.
- When the government expenditure exceeds its receipts, it is deficit budget.
- When the government revenue is greater than its expenditure, the government runs a budget surplus.

Thus:

Balance budget $\rightarrow$ Total Budgeted Receipt = Total Budgeted Expenditure

Dificit budget $\rightarrow$ Total Budgeted Receipts < Total Budgeted Expenditure

Surplus budget $\rightarrow$ Total Budgeted Receipts > Total Budgeted Expenditure

There was a time when budget surplus was regarded as an index of a good budget. However, in modern economy budget deficit has become order of the day.

29.4 TYPES OF BUDGET DEFICIT

1. **Revenue Deficit:** It refers to the excess of total revenue expenditure of the government over its total revenue receipts.

   Revenue deficit = Total Revenue expenditure – Total Revenue receipts.

   OR

   Revenue deficit = Total Revenue expenditure – (Tax Revenue + Non Tax Revenue)

2. **Fiscal Deficit:** Fiscal deficit is defined as excess of total expenditure over total receipts excluding borrowings during a fiscal year.

   Fiscal deficit = Total budget expenditure – Total budget receipts excluding borrowings

   OR

   Fiscal Deficit = (Revenue expenditure + Capital expenditure) – (Revenue Receipts + Capital receipts excluding borrowings)

   Fiscal deficit shows the borrowing requirements of the govt. during the budget year. Fiscal deficit reflects the borrowing requirements of the govt. for financing the expenditure including interest payments.

   Fiscal deficit = Revenue expenditure + capital expenditure – Revenue receipts – capital Receipts excluding borrowings

   OR

   Fiscal deficit = Revenue expenditure + capital expenditure – Tax Revenue – Non Tax Revenue – recovery of loans – disinvestment

   OR

   Fiscal deficit = Total borrowing requirement of the government

   Fiscal deficit indicates the additional amount of financial resources needed to meet government expenditure. Two, it is an indicator of the increase in future liabilities of the government on interest payment and loan repayment. The government has to pay back the borrowed amount with interest in future. Consequently, the government has to either borrow more from the people or tax people more in future to pay interest and loan amount.

3. **Primary Deficit:** Primary deficit is defined as fiscal deficit minus interest payments on previous borrowings.

   Primary deficit shows the borrowing requirements of the govt. for meeting expenditure excluding interest payment.

   Gross Primary deficit = Fiscal deficit – Interest payments

Net Primary deficit = Fiscal deficit + Interest received – Interest payments

It shows the total amount that the central government needs to borrow.

Three Ways to Finance Deficit

There are **three ways** by which the central government finances deficit. These are:

(a) Borrowing from Public and Foreign Governments

(b) Withdrawing Cash Balances held with the Reserve Bank of India (R.B.I.)

(c) Borrowing from the Reserve Bank of India (R.B.I)

The Government ordinarily prefers to borrow either from its citizens or from foreign governments instead of withdrawing cash balances held with the R.B.I. or borrowing from it. The later two ways to finance deficit increase the supply of money. The increase in supply of money increases the prices in an economy. On the other hand, borrowing domestically from public has no effect on the supply of money and consequently on prices because when government borrows, the money held by people is transferred to government with no change in the supply of money. However, the money supply would increase when government borrows from foreign countries. The last two ways to finance deficit increase the supply of money. Any money that flows out of the R.B.I. increases the supply of money in economy and increases the prices in domestic economy.

29.5 BUDGETARY POLICY (FISCAL POLICY)

Now you will know about budgetary policy. Budgetary policy relates to two important issues. These are:

1. The items on which the government should spend
2. How the government should raise resources to finance its expenditure?

The answer to the first question will depend on the priorities of the government to solve various economic, social and other problems that a country faces. For example, if there is a constant threat of attack from another country, the government has no choice but to spend more on defence. If there is a threat of outbreak and spread of an epidemic, the government has to spend more on health services. If the government had taken loan in the past, it has to spend more on interest payments.

On the second question the government has to consider various ways to raise resources. Should the people be taxed more? Which section of the people to be taxed more? Which commodities are to be taxed? How much the government should borrow? From whom should it borrow and in what form? The answers to these questions are to be found in the policy objectives of the government.

The fiscal policy is concerned with the raising of government revenue and increasing expenditure. To generate revenue and to increase expenditures, the government finance or policy called Budgeting policy or fiscal policy.

The major fiscal measures are:

1. **Public Expenditure** – Government spends money on a wide variety of things, from the military and police to services like education and health care, as well as transfer payments such as welfare benefits.
2. **Taxation** – Government imposes new taxes and change the rate of current taxes. The expenditure of government is funded by the imposition of taxes.
3. **Public Borrowing** – Government also raises money from the population or from abroad through bonds, NSC, Kisan Vikas Patra, etc.
4. **Other Measure** – Other measures adopted by the government are:
   (a) Rationing and price control
   (b) Regulation of wages
   (c) Increase the production of goods and services.

Objectives of Budget and Budgetary Policy

1. **To promote economic growth:** Government promotes economic growth by setting up basic and heavy industries like steel, chemical, fertilizers, machine tools, etc. It also builds infrastructure like roads, canals, railways, airports, education and health services, water and electricity supply, telecommunications, etc. that foster economic growth.

   Both basic and heavy industries and infrastructure require huge amount of investment which normally the private sector does not take up. Since these industries and infrastructure facilities are essential for economic growth in the country, the burden to set up and develop them falls on the government.
2. **To reduce income and wealth inequalities:** Government reduces inequalities in income and wealth by taxing the rich more and spending more on the poor. Further, it provides for the employment opportunities to poor that help them to earn.
3. **To provide employment opportunities:** Employment opportunities are increased by the government in various ways, One, jobs are created when it sets up public sector enterprises. Two, it provides subsidies and other incentives like tax holidays, low rates of taxes etc. to private sector that encourage production and employment. It also encourages setting up of small scale, cottage and village industries by people which are employment oriented. This it does by providing them tax concessions, subsidies, grants, loans at low rates of interest, etc. Finally, it creates jobs for poor when it undertakes public works programmes like construction of roads, bridges, canals, buildings, etc.

4. **To ensure stability in prices:** Government ensures stability of prices of essential goods and services by regulating their supplies. Hence, it incurs expenditure on ration and fair price shops that keep sufficient stock of food grains. If also subsidizes cooking gas, electricity, water and essential services like transport and maintains their prices at low level affordable to the common man.

5. **To correct balance of payments deficit:** The balance of payments account of a country records its receipts and payment with foreign countries. When payments to foreigners are more than receipts from foreigners, the balance of payments account is said to be in deficit. Quite often this deficit is caused when a country imports more than it exports. Consequently, the payments on imports to foreigners are more than the receipts from exports. In such a situation, to reduce the deficit in balance of payment account, the government discourages imports by increasing taxes on them and encourages exports by increasing subsidies and other export incentives. However, it should be noted that tax on import is not a popular measure now as it is treated as an obstacle to free flow of goods and services between countries.

6. **To provide for effective administration:** Government incurs expenditures on police, defence, legislatures, judiciary, etc. to provide effective administration.

INTEXT QUESTIONS 29.2

Fill in the blanks with appropriate word(s) within the brackets.

1. Government budget is in deficit when total budgeted expenditure is .... total budgeted revenue. (less than, greater than, equal to)
2. Fiscal deficit .... government borrowings. (includes, excludes)
3. Budgetary deficit is .... measure of deficit compared to fiscal deficit. (a better, not a better)
4. Money supply .... when government borrows from the Reserve Bank of India. (decreases, increases)

WHAT YOU HAVE LEARNT

- Government budget is a consolidated financial statement relating to a financial year of expected item wise expenditures and expected revenue of government for fiscal year.
- The receipts in a government budget are of two types: (1) Revenue receipts and (2) Capital receipts.
- The sale of its own shares in public sector undertakings by government is known as 'disinvestment of public sector undertakings'.

- Government expenditure is classified as (1) Revenue and Capital expenditure and as (b) Plan and Non-Plan expenditure.
- Budget deficit is the excess of total budgeted expenditure over total budgeted receipts *net of borrowings*. It indicates the total borrowing requirement of government.
- Three ways by which the central government finances deficit:
  - (i) Borrowings from public and from foreign governments.
  - (ii) Withdrawing cash balances held with the Reserve Bank of India.
  - (iii) Borrowings from the Reserve Bank of India.
- The selection of items of expenditure and sources of financing them in tune with policies and programmes of the government, is termed as the budgetary policy of government.
- The main objectives of budget and budgetary policy are:
  - (i) to promote economic growth,
  - (ii) to reduce income and wealth inequalities,
  - (iii) to provide employment opportunities,
  - (iv) to ensure stability in prices,
  - (v) to correct balance of payments deficit and
  - (vi) to provide for effective administration.

TERMINAL EXERCISE

1. What is a government budget? What do you understand by the term 'financial year'?
2. Outline the structure of government budget and briefly explain its various constituents.
3. Distinguish between revenue receipts and capital receipts.
4. Distinguish between revenue expenditure and capital expenditure.
5. Distinguish between plan and non-plan expenditure.
6. Distinguish between surplus budget and deficit budget. How do they limit the economic activity?
7. State the difference between fiscal deficit and budgetary deficit.
8. Why fiscal deficit is a better measure of deficit as compared to budgetary deficit?
9. What are the different ways to finance deficit in government budget? Explain them.

10. State the effects of government borrowing from public and from Reserve Bank of India. Which one is better and why?
11. State and explain the objectives of budgetary policy.
12. Explain the need of government budget.

ANSWERS TO INTEXT QUESTIONS

29.1

1. (b)   2. (d)   3. (d)

29.2

1. (greater than)   2. (excludes)   3.(not a better)   4. (increases).