21
GOVERNMENT BUDGETING

21.1 INTRODUCTION

You may be knowing that government's budget in India is normally presented in the month of February every year in the Parliament. You must have also observed that many days before the budget is presented, there are speculations all round by the people about the expected changes in taxes. Are rates of income tax going to be reduced? Is tax on cigarettes going to be increased? Is tax on cooking gas going to be increased? People generally talk about only those aspects of expected changes in budget which affect their pockets directly. It may give an impression that government budget is merely an exercise only in increasing or decreasing rates of taxes. But the fact is that government budget is much more than this. Besides changing tax rates government budget is a comprehensive exercise in allocating expenditure and planning the sources of financing this expenditure. This lesson aims at describing the structure of a government's budget and the aims behind the exercise of framing this budget.

21.2 OBJECTIVES

After going through this lesson you will be able to :

- explain the meaning of a government budget;
- state the components of government budget;
- explain the meaning and composition of revenue receipts and capital receipts;
- distinguish between capital and revenue expenditure;
- distinguish between plan and non-plan expenditure;
- explain the concepts of budgetary deficit and fiscal deficit;
- explain the sources of financing deficits;
- explain the meaning and objectives of budgetary policy.

21.3 WHAT IS A GOVERNMENT BUDGET?

A government budget is a statement of expected expenditure of the government and the sources of financing these expenditure during a financial year. Such an exercise is undertaken much before the financial year starts. The statement details all expenditures to be incurred during the coming financial year and the sources of meeting this expenditure.

Governments at all levels, central, state or local, prepare budgets. Government takes decisions on behalf of the people. It is, therefore, accountable to the people through legislatures, parliament, civic bodies etc. The budget is prepared keeping in view the general policy of the government aimed at the welfare of the people. Some of the objectives may be to provide basic facilities, raise production, reduce unemployment, control price level, reduce inequalities in income and wealth. Items of expenditure and the sources of financing are planned keeping in mind these objectives. Implementation of government policies through budget formulation is termed as fiscal policy or budgetary policy. (A detailed discussion on fiscal policy is made in section 21.7 of this lesson).

In brief, the main aspects of a government budget are :

(1) It is a statement of expected expenditure and sources of financing this expenditure.

(2) It relates to a financial year.

(3) Expenditure and sources of finance are planned in accordance with declared policy objectives of the Government.

21.4 COMPONENTS OF GOVERNMENT BUDGET

(a) Structure of a budget

The basic structure of a government budget is nearly the same at all levels of government. The items of expenditure, the weightage given to different items and the sources of finance may differ from budget to budget. In this section we will explain the structure of the budget as prepared by the central government in India. As reference we take the budget for the year 1995-96. (Table 21.1)

Table : 21.1

Budget Estimates of Central Government (1995-96)

(thousand crores of Rupees)

	RECEIPTS		
1.	**Revenue receipts**		
	(a) Tax revenue (net)	74	
	(b) Non-tax revenue	27	
	Total (a) + (b)		**101**
2.	**Capital receipts**		
	(a) Recoveries of loans	7	
	(b) Other receipts	7	
	(c) Borrowings and other liabilities	52	
	Total (a) + (b) + (c)		**66**
3.	**Total receipts (1+2)**		**167**
	EXPENDITURE		
4.	**Revenue expenditure**		
	(a) Non-plan	107	
	(b) Plan	29	
	Total (a) + (b)		**136**
5.	**Capital expenditure**		
	(a) Non-plan	17	
	(b) Plan	19	
	Total (a) + (b)		**36**
6.	**Total expenditure (4+5)**		**172**
7.	**BUDGETARY DEFICIT (=6-3)**		**5**

The budget has two main parts : (a) Receipts and (b) Expenditures. The lower part of the table 21.1 records expenditure planned to be incurred on various groups of items during a given year. The upper part records receipts or the planned sources of financing these expenditures. At the end of the table is recorded budgetary deficit which equals the excess of expenditure over receipts. (The concept of deficits are explained in section 21.5). In the next section various items of expenditure and receipt are explained.

(b) Receipts

The receipts of the Government are of two types : (a) Revenue receipts and (b) Capital receipts. Revenue receipts are current income receipts from all sources. The main forms of such receipts are taxes, profits of public enterprises, grants, etc. Capital receipts constitute borrowing of the government.

There is an important difference between revenue and capital receipts. In revenue receipts government is under no future obligation to return the amount. Capital receipts, on the other hand, being borrowings, the government is under obligation to return the amount alongwith interest. All capital receipts create liabilities or reduce assets.

There is a similarity in financing by an individual and financing by government. An individual first tries to finance current expenditure from his current income. In case he finds that his current income is not sufficient he tries to finance by borrowing. As even for an individual current income and borrowings are the two possible sources of financing expenditures. What is true about an individual is also true about the government.

There is dissimilarity also. An individual first estimate his expected income and then plans expenditures accordingly. A government, generally, first estimates the expenditures and then plans the sources of financing these expenditures.

21.5 REVENUE RECEIPTS

Taxes have been the traditional source of government's income since time immemorial. During the present century another source of government's income emerged. Government has started participating in production by opening enterprises of their own. Such enterprises are called public enterprises. Railways, nationalized banks, State Trading Corporation, Air India, Indian Airlines, are some examples of public enterprises. **Profits of public enterprises** is a source of income to the government. There is another source in addition to taxation and profits. Government may also get grants from foreign countries. All these sources are called revenue receipts and classified into :

(a) Tax revenue, and

(b) Non-tax revenue

(a) Tax revenue

What is a tax? A tax is a legally compulsory payment imposed on the people by the government. You must have heard about the taxes like income tax, sales tax, excise duty etc. Income tax is imposed on those who earn income. We earn income in the form of wages, salaries, rent, interest and profit. In India, in the year 1998-99, every individual whose income exceeded Rs. 50,000 in a year was liable to pay income tax. Rs. 50,000 is the exemption limit and may change from year to year. Sales tax is imposed on the sale of goods and services. You must be paying sales tax on many goods you buy. Excise duty is a tax on manufacturing goods. There are other types of taxes also like wealth tax, gift tax, octroi, import duty etc.

Who bears the burden of tax? Or, who actually pays the tax? Take, for example, income tax. It is paid out of the income one earns. In other words, if the tax is imposed on Ram's income it is actually goes out of the pocket of Ram. Ram bears the burden as well as makes payment to the government.

Now, take the example of sales tax. What is true about income tax may not be true about sales tax? It is the responsibility of the seller to pay sales tax to the government. But does he pay from his pocket? No. He collects the tax from the buyer first and then pays the same to the government. It means that the seller passes on the burden to the buyer. It is the buyer who actually bears the burden of tax but it is the seller on whom lies the responsibility of depositing the same with the government. In other words, it is the buyer who indirectly pays sales tax to the government.

Direct tax vs. Indirect tax :

We have given above the examples of income tax and sales tax. We find that the two taxes are different with respect to (a) the liability of payment of tax to the government and (b) actual burden of the tax.

In case of income tax the liability of payment and the burden both lie on the same person. In this case the burden of tax cannot be shifted to other persons. Such a tax is called **direct tax.**

In case of sales tax the liability of payment to government lies on the seller while the actual burden of tax lies on the buyer. The buyer pays sales tax to the seller who in turn pays the same to the government. Such a tax is called **indirect tax.** In case of such a tax the burden is shifted to other persons. All taxes on production are indirect taxes because the producer tries to recover these taxes from the buyers.

All taxes are thus broadly classified into (a) direct taxes and (b) indirect taxes. Main examples of such taxes in India are:

Direct taxes :

1. Corporation tax : It is an income tax on profits of companies.

2. Income tax : It is an income tax on incomes of individuals.

3. Interest tax : It is a tax on interest income.

4. Expenditure tax : It is a tax on expenditure incurred.

5. Wealth tax : It is a tax on wealth of individuals.

6. Gift tax : It is a tax on gifts given.

Indirect taxes

1. Customs duties : These are taxes on imports and exports.

2. Union excise duties : These are taxes on manufacturing goods imposed by the Union government.

3. Service tax : It is a tax on producing services.

4. Sales tax : It is a tax on sales.

(b) Non-tax revenue

Non-tax revenue is the income accruing to the government from sources other than tax. The three major sources of the non-tax revenue of the central government in India are :

(i) Interest receipts : Central government departments give loans to people, enterprises, local governments etc. and receive interest in return.

(ii) Dividends and profits : Central government owns production units. These are called public sector enterprises who produce goods and services like private enterprises do. Some examples are Railways, Air India, Mahanagar Telephone Nigam, nationalized banks etc. Central government is either shareholder or owner of such enterprises and receives dividends and profits in return.

(iii) External grants : Government departments receive financial help from foreign governments in the form of donations, gifts, etc.

21.6 CAPITAL RECEIPTS

There are three major sources of capital receipts of central government : (a) Borrowings, (b) Recovery of loans and (c) Resale of shares of public sector undertaking.

(a) Borrowings :

Central government borrows from two sources :

(i) Domestic borrowings : These are the borrowings from within the country. Government borrows from the financial market by issuing government securities and treasury bills. Government also borrows from people through the various deposit schemes like Public Provident Fund, Small Saving Schemes, Indira Vikas Patras, Kisan Vikas Patras, National Saving Scheme, National Saving Certificates, etc. The money deposited in these scheme is loan to the government.

(ii) External assistance : These are the borrowings from foreign countries.

(b) **Recovery of Loans :**

Central government gives loans to state and local governments in the country. Recovery of these loans constitute capital receipts in the budget.

(c) **Resale of Shares of Public Sector Undertakings :**

It is a recent source of capital receipts. Until recently central government owned 100 percent shares of public sector undertakings. It means that the entire investment in these enterprises was made by the central government. In 1991 the central government adopted the policy of privatising these undertakings. As first step towards implementation of the policy the central government has started reselling the shares held by it to the general public and financial institutions. Resale of such share by government is termed as **'disinvestment in shares'.**

21.7 EXPENDITURES

All government expenditure can be classified into groups in two ways. One way is to classify these expenditures into capital expenditure and revenue expenditure. Government expenditure can also be classified into plan expenditure and non-plan expenditure. Let us explain the meaning of such expenditures.

(i) Capital vs. revenue expenditure :

Capital expenditure is the expenditure on creation of assets. Such expenditure is incurred on items like construction of buildings, roads, bridges, canals, capital equipments etc.

Revenue expenditure is the expenditure on items which do not lead to creation of any asset. It is incurred on items like payment of salaries, maintenance of property, providing free services to people, etc.

(ii) Plan vs. non-plan expenditure :

India has adopted the path of planning to achieve economic development. Five year plans are prepared and implemented. Provisions are made every year in the government budget about expenditures to be incurred every year according to the priorities laid down in the five

year plans. Provision of such expenditure in the budget is called plan expenditure.

Besides, government also makes provisions for spending on its routine functions of looking after the administration of the country. Planning or no planning such an expenditure is a must for every country. No government can escape from its basic function of protecting the lives and properties of the people. It has to spend on police and judiciary to perform these functions. Government also cannot escape from its function of protecting the country from foreign invasions. For this it has to spend on military. Besides there are routine types of expenditures on various government department, legislatures, provision of public utiliy services like water supply, sanitation, etc. All such expenditures are called non-plan expenditures.

POINTS TO REMEMBER

- Government budget is a statement of expected expenditures and sources of financing these expenditures during a financial year.
- Government receipts are of two types : (a) Revenue receipts and (b) Capital receipts.
- Revenue receipts comprise of tax revenue (i.e. taxes) and non-tax revenue (i.e. interest, dividends and profits of public enterprises and external grants).
- Capital receipts comprise of borrowings, recovery of loans and resale of shares of public sector undertakings.
- Government expenditures can be classified in two ways : (a) Revenue and capital expenditures and (b) Plan and non-plan expenditures.
- Capital expenditure is on creation of assets.
- Revenue expenditure is of routine nature like salaries etc. and does not lead to creation of any asset.
- Provision of expenditure every year according to five year plans is plan expenditure.
- Provision of expenditure on routine functions of government during the year is non-plan expenditure.

INTEXT QUESTIONS 21.1

Choose the correct alternative.

(i) A government budget is a statement of :

(A) Expected expenditures
(B) Expected receipts
(C) Both expected expenditures and receipts
(D) Actual expenditures and receipts.

(ii) Revenue receipts comprise of:

(A) Taxes only
(B) Interest only
(C) Dividends and profit only
(D) All of the above.

(iii) Capital receipts comprise of:

(A) Borrowings only
(B) External assistance only
(C) Recovery of loans only
(D) All of the above.

(iv) Expenditure on construction of bridges by the government is:

(A) Revenue expenditure
(B) Capital expenditure
(C) Both revenue and capital expenditure
(D) Neither revenue nor capital expenditure.

(v) Expenditure on routine functions of government is:

(A) Non-plan expenditure
(B) Plan expenditure
(C) Both non-plan and plan expenditure
(D) Neither plan nor non-plan expenditure.

21.8 DEFICITS IN BUDGET

When expected total receipts fall short of the expected total expenditure, a deficit is said to appear in the budget. There are various concepts of deficit relating to government budget. The type of deficit will depend on the type of receipts taken into account. We will confine here to explaining the two popular concepts of deficit as used in central government's budget in India. The two concepts are : (a) Budgetary deficit and (b) Fiscal deficit.

(a) Budgetary Deficit

This concept is based on all receipts and all expenditures. Budgetary deficit is defined as the excess of all budgeted expenditures over all budgeted receipts. Or,

Budgetary deficit = Total budget expenditure - Total budget receipts

The above measure takes into account both revenue and capital receipt and both revenue and capital expenditures. For example, in the central government's budget of 1995-96, the total expenditure was Rs. 172 thousand crores while total receipts were Rs. 167 thousand crores. It means that budgetary deficit was around Rs. 5 thousand crores. (=172-167). It means that the central government's total receipts were falling short of its total expenditure by Rs.5,000 crores.

(b) Fiscal Deficit

This concept of deficit does not take into account all types of receipts. It does not take into account borrowings. As such fiscal deficit is defined as the excess of all expenditures over total receipts reduced by borrowings. Or,

Fiscal deficit = Total budget expenditure – Total budget receipts net of borrowings.

For example, in the central government's budget of 1995-96 (Table 21.1) total expenditure was Rs. 172 thousand crores while receipts other than planned borrowings were Rs. 115 thousand crores. As such fiscal deficit was Rs. 57 thousand crores (=172-115). In other words fiscal deficit (Rs.57,000 crores) equals budgetary deficit (Rs.5,000 crores) plus planned borrowings (Rs.52,000 crores).

Fiscal deficit indicates the total amount by which the central has to resort to borrowings. It means that government must borrow from one source or the other Rs. 57 thousand crores to finance its expenditures during the year. In the budget the government already has a planned borrowing of Rs. 52 thousand crores. It has to find some source of financing Rs.5,000 crores.

(c) Why is fiscal deficit a better measure?

Fiscal deficit is a comprehensive and a better measure of deficit as compared to budgetary deficit. We can say so on account of two reasons. First, it is an indicator of real volume of problem of finding resources to meet expenditure needs. It indicates the expected total increase in liabilities during the year. Budgetary deficit indicates only a part of this. Second, fiscal deficit is also an indicator of increase in future liabilities in the form of interest payments and loan repayments. When government borrows it has also to pay back this money with interest. In order to pay interest and repay loan government may have to either borrow more or tax people heavily in future years.

21.9 SOURCES OF FINANCING DEFICIT

There are three sources by which the Government can finance the deficit. These are :

(a) Borrowings from public and foreign governments.

(b) Withdrawing from its cash balances with Reserve Bank of India.

(c) Borrowings from the Reserve Bank of India.

To finance its expenditure government likes to borrow from public rather than withdraw cash balances or borrow from the Reserve Bank of India? The reason is found on the effects on money supply in the country. (The concept of money supply is explained in lesson No. 22). Borrowing from public has no effect on money supply in the country. When government borrows, money is transfered from the public to the government. The net effect on total money supply in the country is nil.

On the other hand withdrawals from cash balances held in Reserve Bank and borrowing from Reserve Bank leads to increase in money supply. Any money that flows out of Reserve Bank of India leads to increase in money supply. This increase in money supply in turn may lead to rise in prices and may create many problems in the economy. As such government will like to use this source only when it is forced to do so and when no other option of financing is left.

It should not be taken to mean that borrowing from public creates no problems. It may create problems but not that serious as arise from borrowing from the Reserve Bank of India. As we have already pointed out earlier borrowing from public raises liability of government in two ways. First, government has to repay back loans in future. Second, government has to pay interest on these loans. Government generally borrows from the public in the hope that it will be able to raise additional resources in the near future and pay back loans and interest out of these. If government fails to raise additional resources in future even borrowing from public may create problems.

21.10 OBJECTIVES OF BUDGETARY POLICY

(a) Meaning of budgetary policy

A budget is a statement of expenditures and receipts of the government relating to a financial year. As such the Finance Minister has two broad questions before him. What are the items on which government should spend? How to raise resources to finance this expenditure?

Should government spend more on defence services or more on services needed by civilians? How much should the government spend on education, sanitation, hospitals, police, etc. There is no straight answer to these questions. The answer will depend on the priorities of the government which are determined by the economic, social and other problems faced by the country. For example, if there is a constant threat of attack from a foreign country the government has no option but to spend more on military. If there is a threat of spread of an epidemic government has to spend more on hospitals etc. If government had taken loans in the past it has to spend on interest payments.

'How to raise resources to finance this expenditure?' is the other question before the government. Should people be taxed more? Which section of the people to be taxed more? Which commodities are to be taxed? How much should government borrow? From where should it borrow? In what form should it borrow?

The answers to these above stated questions are to be found in the policy objectives of government. Any government would allocate expenditure among different items and select sources of finance in the light of its policy and priorities. The selection of items of expenditure and sources of finance in tune with government's policies and programmes is what is termed as budgetary policy of the government.

(b) Objectives of budgetary policy

The main objectives of any budgetary policy are :

(1) Providing effective administration :

To fulfil this objective government incurs expenditure on police, military, legislatures, courts, government offices etc.

(2) Providing infrastructural facilities

For this the government spends on education, health, sanitation, water and electricity supply, transport, post and telecommunications services, roads, bridges, parks, etc.

(3) Providing employment opportunities

To fulfil this objective government can take many steps. It can open public enterprises. It can provide subsidies to private enterprises to encourage production and employment. It can encourage small scale, cottage and village industries by giving tax concessions, subsidies, grants, loans etc. It can undertake public works programmes like construction of roads, bridges, government buildings etc. to generate employment.

(4) Ensuring stability in prices

Government must ensure stability of prices particularly of essential goods and services. It can do so by opening fair price shops, keeping sufficient stock of food grains etc., fixing up of maximum prices of goods needed by common man like cooking gas, electricity, petrol, etc.

(5) Reducing inequalities of income

Government can do so by taxing the rich more and spending more on the poor.

(6) Promoting economic growth

Government can promote economic growth by setting up basic and heavy industries like steel, chemicals, fertilizers, machine building, etc. These industries are normally not taken up by the private sector because these involve huge amount of investment. But the existence of these industries is essential to encourage the opening of other industries.

(7) Correcting the balance of payments deficit

Balance of payment is an account which records receipts and payments with foreign countries. When foreign payments are more than foreign receipts a deficit appears. The cause of this deficit is found in more imports and less exports. To reduce this deficit government can discourage imports by putting heavy taxes on imports and encourage exports through subsidies and tax-incentives.

POINTS TO REMEMBER

- Budgetary deficit is defined as the excess of total budgeted expenditures over total budgeted receipts.
- Fiscal deficit is defined as the excess of total budgeted expenditures over budgeted receipt excluding borrowings. It indicates total borrowing requirements of the government.
- There are three sources of financing deficits in budget. These are : (a) Borrowings from public and foreign governments, (b) Withdrawing from cash balances held in Reserve Bank of India, and (c) Borrowings from Reserve Bank of India.
- Budgetary policy refers to the selection of items of expenditure and the sources of finance in tune with government's policies and programmes.
- The main objectives of a budgetary policy are
  1. Providing effective administration
  2. Providing infrastructural facilities
  3. Providing employment opportunities
  4. Ensuring stability in prices
  5. Reducing inequalities of incomes
  6. Promoting economic growth
  7. Correcting the balance of payments deficit

INTEXT QUESTIONS 21.2

Fill in the blanks with appropriate word from the brackets:

(i) A deficit in the budget arises when expected expenditures ________________ expected receipts. (exceed, fall short of)

(ii) Excess of ________________ (total expenditure, total receipts) over ________________ (total expenditure, total receipts) equals budgetary deficit.

(iii) Fiscal deficit is calculated on the basis of receipts ________________ (including, excluding) borrowings.

(iv) Borrowing from Reserve Bank is ________________ (preferred, not preferred) to borrowing from public to cover budget deficit.

(v) Fiscal deficit is ________________ (better, not better) measure of deficit as compared to budgetary deficit.

WHAT YOU HAVE LEARNT

- Government budget is a statement of expected expenditures and receipts during a year.
- Receipts comprise of revenue receipts (taxes, interest, dividends, profits and external grants) and capital receipts (borrowings, recovery of loans and resale of shares of public undertakings).
- Expenditures can be classified as revenue (i.e. non-asset creating) expenditure and capital (i.e. asset creating) expenditure.
- Expenditures can also be classified as plan (i.e. according to five year plans) expenditure and non-plan (i.e. on routine functions) expenditure.
- Budgetary deficit equals the excess of total budgeted expenditure over total budgeted receipts.
- Fiscal deficit equals total budgeted expenditure over budgeted receipts net of borrowings.
- The three sources of financing budget deficit are :
  (a) Borrowings from public and foreign governments.

(b) Withdrawing from cash balances held in Reserve Bank of India.
(c) Borrowings from Reserve Bank of India.

- The main objectives of a budgetary policy are :
  (a) Providing effective administration.
  (b) Providing infrastructural facilities.
  (c) Providing employment opportunities.
  (d) Ensuring stability in prices.
  (e) Reducing inequalities of incomes.
  (f) Promoting economic growth.
  (g) Correcting the balance of payment deficit.

TERMINAL EXERCISE

1. Explain the meaning of a government budget. Give an outline of the structure of a government budget.

2. Distinguish between revenue receipts and capital receipts.

3. Explain the composition of revenue receipts and capital receipts.

4. Distinguish between capital and revenue expenditures.

5. Distinguish between plan and non-plan expenditures.

6. Explain the concepts of budgetary deficit and fiscal deficit.

7. State the different sources of financing deficit in budget.

8. Explain the meaning and objectives of budgetary policy.

ANSWERS

Intext Questions 21.1

(i) C, (ii) D, (iii) D, (iv) B, (v) A

Intext Questions 21.2

(i) exceed, (ii) total expenditure, total receipts (iii) excluding, (iv) not preferred, (v) better.

Terminal Exercise (Hints only)

1. A government budget is a statement of expected expenditures and the sources of financing these expenditures during the financial year. A government budget has two parts : (a) Receipts and (b) Expenditures. Receipts are broadly classified into revenue and non-revenue receipts. Expenditures are classified as revenue & non-revenue and plan & non-plan expenditures. (Read section 21.3 & 21.4)

2. Revenue receipts are current income receipts from all sources. Capital receipts constitute borrowings. (Read section 21.5 & 21.6)

3. (a) Revenue receipts comprise of tax revenue (direct & indirect taxes) and non-tax revenue (interest receipts, profits and dividends and external grants).

   (b) Capital receipts include (1) Borrowings both domestic borrowings and external assistance, (2) Recovery of loans and (3) Resale of shares of public sector undertakings. (Read section 21.5 & 21.6)

4. Capital expenditure is on creation of assets. Revenue expenditure is on routine expenditure like salaries, maintenance of property etc. (Read section 21.7 a)

5. Expenditure according to five year plan priorities is plan expenditure. Expenditure of routine type like on salaries etc. is non-plan expenditure. (Read section 21.7 b)

6. Budgetary deficit = Total budget expenditure – Total budget receipts
   Fiscal deficit = Total budget expenditure – Total budget receipts net of borrowings.
   (Read section 21.8)

7. (i) Borrowings from public and foreign governments.
   (ii) Withdrawing from cash balances held in Reserve Bank of India.
   (iii) Borrowings from Reserve Bank of India
   (Read section 21.9)

8. The selection of items of expenditure and source of finance in tune with government policies and programs is broadly referred to as budgetary policy.

Its objectives are:

(i) Provide effective administration of the country.
(ii) Provide infrastructural facilities.
(iii) Provide employment opportunities.
(iv) Ensure stability in prices.
(v) Reducing inequalities of incomes.
(vi) Promoting economic growth.
(vii) Controlling balance of payments deficit.
(Read section 21.10)