UNIT-4

BUDGET

Budget

- Planning process of assessing revenue & expenditure is termed as Budget.
- The term budget is derived from the French word "Budgette" which means a "leather bags; or a "wallet". It is a statement of the financial plan of the government. It shows the income & expenditure of the government during a financial year, which runs generally from 1st April to 31st March.

- So, every citizen of a nation from the common man to the politician is **eager to know about the budget** as they would like to get an idea of the: -
- ¤ **Financial performance** of the government over the past one year.
- ¤ To know about the **financial programmes & policies** of the government for the next one year.
- ¤ To know how their **standard of living** will be affected by the financial policies of the government in the next one year.

OBJECTIVES OF BUDGET

- **Allocation of resources**: Keeping into view the socio-economic and other objectives which a government wants to achieve, re-sources are allocated through budget. In India, the most important activity is to accelerate the rate of economic development and for that resources are allocated on a large scale.
- **Redistributive activities:** A developing economy like India is generally the victim of many social and economic problems which need to be solved as early as possible. The important problems are the problem of poverty, unemployment, income inequalities, illiteracy etc.

- 3. **Economic stability:** Inflation and deflation both are not good from economic point of view; Therefore, whenever a country suffers from inflation or deflation, besides other corrective measures, appropriate budgetary steps are taken to remedy the situation.
- 4. **Management of public enterprises:** To curb monopolies in heavy, basic and key sectors owned and managed by private enterprises, government establishes and operates such units in the public sector, this is necessary to avoid distortion of priorities of the government and society.

- **Other Objectives**
- 5. Help in Economic planning
- 6. Tool for fiscal policies
- 7. Basis of public welfare
- 8. Legislative control on public funds
- 9. Tool of administrative efficiency.

- **REVENUE BUDGET**
- This financial statement includes the revenue receipts of the government i.e. revenue collected by way of taxes & other receipts. It also contains the items
- **Revenue Receipts**
- These are the incomes which are received by the government from all sources in its ordinary course of governance. These receipts do not create a liability or lead to a reduction in assets.
- **Revenue receipts are further classified as tax revenue and non-tax revenue.**
- 1. Tax Revenue:-Tax revenue consists of the income received from different taxes and other duties levied by the government. It is a major source of public revenue. Every citizen, by law is bound to pay them and non-payment is punishable.

- **The non-tax sources of public revenue are as follows: -**
- ▫ Fees: The government provides variety of services for which fees have to be paid. E.g. fees paid for registration of property, births, deaths, etc.
- ▫ Fines and penalties: Fines and penalties are imposed by the government for not following (violating) the rules and regulations.
- ▫ Profits from public sector enterprises: Many enterprises are owned and managed by the government.
- ▫ Gifts and grants: Gifts and grants are received by the government when there are natural calamities like earthquake, floods, famines, etc.

- **REVENUE EXPENDITURE**
- 1. Expenses included in Revenue Expenditure –In general revenue expenditure included following –
- ▫ Expenditure by the government on consumption of goods and services.
- ▫ Expenditure on agricultural and industrial development, scientific research, education, health and social services.
- ▫ Expenditure on defence and civil administration.
- ▫ Expenditure on exports and external affairs.
- ▫ Grants given to State governments
- ▫ Payment of interest on loans taken in the previous year.
- ▫ Expenditure on subsidies.

- 2. Capital Receipts
- This part of the budget included receipts & expenditure on capital account projected for the next financial; year. Capital budget consists of capital receipts & capital expenditure.
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- Items included in Capital Receipts – The main items of Capital receipts (income are – ¤ Loans raised by the government from the public through the sale of bonds and securities. They are called market loans.

- ¤ Borrowings by Government from RBI and other financial institutions through the sale of Treasury bills.
- ¤ Loans and aids received from foreign countries and other international Organizations like International Monetary Fund (IMF), World Bank etc.
- ¤ Receipts from small savings schemes like the National saving scheme, President fund, etc.

Definition of Deficit Financing

- Deficit financing, thus, refers to the financing of the excess expenditure over the total revenue receipts of the government during a year, by various methods. Deficit Financing = Total Public Expenditure—Total Public Revenue.
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Deficit Financing in Developed Countries

- Deficit financing in developed countries refers to the financing of expenditure, through borrowings — whether internal or external and whether from the central bank, commercial banks, non-banking institutions or from individuals and corporations (market loans).

- **Effects of deficit financing**
- Today financing is resorted to by the governments of both developed and developing countries. It is, therefore, necessary to examine the reasons for deficit financing for the two types of economies.

Reasons for Deficit Budgets in Advanced Countries

- 1. For wars- Deficit financing was used earlier for financing of wars. The form of this deficit financing was mainly internal borrowings from the market (Vern people arid financial institutions) and external borrowings.
- 2. Depression (anti-cyclical instrument)- J.M. Keynes on his book, General Theory of Employment Interest and Money. Advocated deficit financing of government expenditure to fight depression pumping more money into the, economy to increase effective demand on the country.

- 3. To maintain full employment- Now, deficit financing, particularly through public borrowings, is used by developed countries to maintain the full employment level.
- 4. To prevent recessionary trends- No government of an advanced country ran wait till the depression sets in. Whenever there are symptoms of recessionary trends in the economy', the government of an advanced country does not hesitate to resort to' sorne kind of deficit financing in the country to prevent recessionary trends.

- 5. To fill up budgetary deficit (functional finance)- Since the concept of “balanced budget" has been abandoned long back, budgets now looked upon as a functional instrument to regulate the economy.

What is Fiscal Responsibility and Budget Management Act?

- Fiscal Responsibility and Budget Management (FRBM) Act enacted in 2003 by the Indian parliament aims at bringing **financial discipline on government expenditure.**
- Aimed primarily to bring a check on revenue deficit, the act strives to improve the overall management of public finance by controlling unchecked borrowings and imparting financial discipline.

- The Fiscal Responsibility and Budget Management Bill, 2000 was introduced in the Lok Sabha by the then Finance Minister of India, Mr. Yashwant Sinha under the then National Democratic Alliance Government led by Mr. Atal Bihari Vajpayee.
- **The prime purpose of this bill was to control the fiscal deficit both at the centre and at the level of the states** through prudent utilization of the public funds and ultimately bringing fiscal deficit of the country within a limit of 3% of the Gross Domestic Product (GDP) and revenue deficit to zero levels by March 2006. The bill had been a slow mover since the beginning.
- The bill was introduced in the Parliament in December 2000 but it was passed by the Parliament on August 26, 2003.

Fiscal Responsibility and Budget Management (FRBM) Act, 2004

- **The FRBM bill had stated its important objectives as follows:**
- i. To make the central government responsible for ensuring inter generational equity in fiscal management and long-term macro-economic stability for attaining a sufficient revenue surplus by eliminating fiscal deficit;
- ii. To remove fiscal impediments in the effective conduct of monetary policy;
- iii. To ensure prudent debt management consistent with the fiscal sustainability through limits imposed on the central governments' borrowings, debt and deficits; and
- iv. To ensure greater transparency in the fiscal operations of the central government.

- The FRBM Act became effective from July 5, 2004. The Act required the elimination of Revenue Deficit by 2008-09. This means from 2008-09 onwards, the central government will have to meet all its Revenue Expenditure from its Revenue Receipts only. Any borrowing would only be to meet capital expenditure, repayment of loans, lending and fresh investment.

Features of FRBM Act

- **1. Revenue Deficit**
- The first important feature of Amended FRBM bill 2000 or FRBM Act 2003 is that the central government should take certain specific measures related with reduction of revenue deficit.
- **2. Fiscal Deficit**
- The second important feature of Amended FRBM bill 2000 or FRBM Act 2003 is that the central government should take certain specific measures related with reduction of fiscal deficit.

- **3. Exceptional Grounds**
  - The third important feature of Amended FRBM bill 2000 or FRBM Act 2003 is that it clearly stated that the revenue deficit and fiscal deficit of the government may exceed the targets specified in the rules only on the grounds of national security or national calamity faced by the country.
- **4. Public Debt**
  - The fourth important feature of Amended FRBM bill 2000 or FRBM Act 2003 is that the central government should ensure that the total liabilities (including external debt at current exchange rate) should not exceed 9% of GDP for the financial year 2004-2005. There should be progressive reduction of this limit by atleast one percentage point of GDP in each subsequent year.

- **5. Fiscal Transparency**
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  The sixth important feature of Amended FRBM bill 2000 or FRBM Act 2003 is related with fiscal transparency. The Amended FRBM bill 2000 or FRBM Act 2003 clearly stated two important measures to ensure greater transparency in fiscal operations of the government.

Criticism / Limitations of FRBM Act 2003

- **1. Target regarding GFD very stringent**

  The Bill stipulates that by March 31, 2006, the Gross Fiscal Deficit (GFD) as a proportion of GDP must be 2%. This, of course, means that the government can borrow from the economy only to the extent of 2% of GDP,

- The increase in public investment helps to increase the level of effective demand and increases private investment in the economy. According to Dr. Raja Chelliah the ratio of Gross Fiscal Deficit (GFD) to GDP should be 4% to 5% of GDP as public investment on infrastructure sector is essential to boost economic growth.

- **Neglect of equity and growth**
- One of the major ommission of amended FRBM Bill 2000 or FRBM Act 2003 was complete absence of any **target for time bound minimum improvement in areas of power generation, transport, etc.** which is very important both from the point of equity and higher economic growth.
- **Neglect of Development Needs**
- Today, the levels of capital expenditures by the government are miserably low in India. These capital expenditures increase the efficiency and productivity of private investment and thus contribute to the development process in the country.

- **Need to Increase Revenue**
  Revenue deficits are determined by the interplay of expenditure and revenues, both tax and non-tax. Too often, attention gets focused only on the expenditure side of the identity to the neglect of the revenue side.
- **Neglect of Social Sector**
  The FRBM bill does not mention anything relating to social sector development. However, investment in social sector such as health, education, etc. is very vital for the economic development of the nation.

- **False Assumptions**
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  The FRBM Bill is based on the following assumptions :-
- Lower fiscal deficit lead to higher growth.
- Larger fiscal deficit lead to higher inflation
- Larger fiscal deficit increase external vulnerability of the economy.