BUDGET

STRUCTURE OF BUDGET

- Budget is the annual financial statement of the estimated receipts and the expenditures of the government.
- It is classified into:-
  - Receipts
    - Revenue Receipts
    - Capital Receipts
      - Sale of assets
      - Disinvestments
      - Recovery of loans
  - Expenditure
    - Revenue Expenditure
    - Capital Expenditure

Difference between Capital and Revenue

If any receipts or expenditure affects any liabilities of the Govt. then it is called Capital, otherwise it is called Revenue

- Liability
  - It means Debt or Loan that needs to be repaid
  - It is affected when government borrows or lends money
- Borrowing can be Internal or External
  - Sources of Internal borrowing
    - Prime source is Financial Institutions i.e. Banks. They buy government securities as they are compelled to buy the same under SLR.
    - Govt. also can borrow from RBI.
  - Source of External borrowing
    - Bilateral - Borrowing from other country's government
    - Multilateral – Borrowing from International Financial Institutions like IMF, World Bank, Asian Development Bank etc.
- Capital Expenditure
  - It is the opposite of Capital Receipts
  - In this government would spend money to buy assets
- Revenue Receipts
  - It is the money received by the government without reducing its assets or increasing its liabilities.
  - This is an income as the money is not supposed to be returned
  - The prime source of income for the Govt. is taxation which is of two types:-
    - Tax Revenue (85% contribution)
    - Non tax revenue (15% contribution)
  - Important Taxes:-
    - Corporate Income Tax (Direct Tax)
    - Income Tax (Direct Tax)
    - Excise (Indirect Tax)
    - Customs (Indirect Tax)
    - Service tax (Indirect Tax)

The activities important for social welfare are placed under departmental undertaking

  - Non Tax Revenue
    - Profit of the Public Sector Companies (PSU) (PSUs are non-departmental undertaking)
    - Profit from economic services like railways, posts etc. These are departmental undertaking.
    - Fees like passport fees, license fees & fines.
    - Gifts, Grants & donations from foreign governments

- Expenditure
  - Capital Expenditure – Assets increase and liability decreases (e.g. - Purchase of assets etc.)
  - Revenue Expenditure – Day to day expenditure or current consumption expenditure of the Govt. (e.g. - Interest payments; salary and pension; Defence expenditure etc.)

BUDGETARY DEFICIT

1. **Budget Deficit**
   - It is excess of total expenditure over total receipts (Total Expenditure – Total Receipts)
   - In India we do not have the concept of Budget Deficit
   - Earlier Budget deficit used to be equal to 91 days ad-hoc treasury bills as till 1997 we used to exclude ad-hoc treasure bills in the total receipt
   - Ad-hoc treasury bills are special type of treasury bills issued by the Govt. only to Central bank to borrow temporarily to cover the mismatch between its receipts and expenditures.
   - Govt started using it as a permanent means of borrowing and never used to repay the loan which lead to unintentional printing of money by the RBI and monetisation of deficit. Due to this ad-hoc treasury bills were abandoned in 1997.
   - After 1 April 1997 Govt. adopted Ways and Means Advances (WMA) which is a kind of overdraft facility.
   - Overdraft facilities are provided by banks to firms against current accounts.

2. **Fiscal Deficit** (called Budget deficit in Europe and America)
   - It is the difference of total expenditure and the total receipts of Govt except borrowing.
   - In simple language Fiscal Deficit means borrowing by Govt. from any sources.
   - Other Formulae – Total Expenditure – (total receipts + non-debt creating capital receipts)
   - Borrowing may be good or bad depending on the use of funds.
   - Fiscal Responsibility and Budget management Act (FRBMA) was passed in 2003 for Govt. to impose limit of deficit.
   - Negative Impacts:-
     - Public debt on Govt increases.
     - If Govt. spending is more, then aggregate demand increases and with that demand price also increases
     - Interest rates increase due to which private investment reduces.
     - It reduces economic resilience of the government.
   - Measure taken to reduce Fiscal Deficit:-
     - It can be done by either reducing total expenditure or by increasing revenue
     - To reduce expenditure Govt has adopted an Expenditure Reforms Commission in 2000. Mr K.P. Geethakrishnan was the chairman.
     - This commission has taken measures like reducing subsidies and reducing Govt. staff.
     - To increase revenue Govt. has initiated Tax reforms and is also planning to introduce GST.
     - Reforms in PSUs
     - Selling off non-viable assets like PSUs and land to pay off debt.
     - Fiscal reforms Committee was set up under the chairmanship of Dr. Vijay L. Kelkar

3. **Revenue Deficit**
   - It is the excess of revenue expenditure over revenue receipts
   - Revenue Deficit = Revenue expenditure – Revenue receipts
   - This deficit is not desirable and is the worst type of deficit as it leads to dilution of assets and increase in liabilities for that expenditure which would benefit Govt. in future.

- Under FRBMA revenue deficit is not allowed
- It should have been reduced to 0% by 2009.
- For the year 2012-13, the target is more than 4%.

4. **Effective Revenue Deficit** (ERD)
    - Revenue Deficit (RD) = Revenue Expenditure – Revenue Receipts
    - Revenue expenditures like interest payments, wages and salaries, grants etc.
    - Majority of the grants are provided for capital expenditure and since the grants are leading to creation of assets, hence they are not revenue expenditure.
    - So Effective Revenue Deficit = Revenue Deficits – Grants for Capital expenditure. It shows the effective reduction of assets or increase in liabilities.
    - The target for ERD is 1.8% of the GDP which is almost half of revenue deficit.

5. **Primary Deficit** (PD)
    - PD = Fiscal Deficit – Interest Payments
    - If govt. borrows in the current financial year, it has to pay interest from the next year or as and when decided by the lender.
    - If primary deficit is zero, it means that Govt. is borrowing just to meet the interest payments.
    - PD's implications depends on various factors like Size of public debt and Level of development
    - There is no target in FRBMA. If Fiscal deficit reduces then PD will also reduce.
    - PD target for this financial year is 1.7% of GDP.

6. **Monetised Deficit**
    - It measures the borrowings of Govt from RBI during the financial year
    - RBI is empowered to print money against Govt security and when Govt borrows from RBI it provides Govt security which leads to printing of money.
    - Currency held by other entities other than Govt is called High Powered Money and this printing of money will increase the High Powered Money.
    - This will result in increase of Money Supply as Money Supply = Money Multiplier x H. This will lead to increase in aggregate demand which will further lead to Inflation.
    - Govt. borrowing money from RBI is also called Deficit Financing.
    - As per FRBMA direct borrowing from RBI is not allowed i.e. monetised deficit is not allowed.

FISCAL POLICY

- Fiscal Policy deals with the revenue and expenditure policy of the Govt.
- The word fiscal has been derived from the word 'fisk' which means public treasury or Govt funds
- Tool of fiscal policy:-
    - Taxation
    - Public expenditure
    - Public debt
    - Plan and Non-Plan Expenditure
- Public Debt means debt on the Govt
- It is accumulated borrowing of the Govt
- Components of Public Debt:-
    - Internal Debt or liabilities
    - Other Liabilities
    - External debt
- Types of Govt. funds
    - Consolidated Fund of India

> High Level committee on public expenditure was set up in 2011 headed by Dr. C Rangarajan.
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> This committee suggested that this classification on plan and no-plan expenditure should be abolished because it is arbitrary.
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> This committee suggested that Govt should use revenue and capital instead of plan and non-plan
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> It has also recommended that the role of planning commission to some extent should be diluted. Instead of finalisation of plans of the state Govt by planning commission this work should be done by Finance Ministry.

- Contingency Fund
- Third Fund also called Public accounts

- **Debt Trap –** Situation where the borrower has to borrow again for the payment of instalment on the previous debt. A borrower unable to meet debt service obligations without borrowing is known to be in debt trap. Eurozone countries are known to be in

Fiscal Responsibility and Budget Management Act (FRBMA), 2003

- The objective of this act is to impose fiscal discipline on government.
- It means fiscal policy should be conducted in a disciplined manner or in a responsible manner i.e. government deficits or borrowings should be kept within reasonable limits and government should plan its expenditure in accordance with its revenues so that the borrowing should be within limits.
- Targets under this act:-
    - Fiscal deficits should be less than 3% of GDP or less by 2008
    - Fiscal deficit should be reduced by 0.3% point per annum
    - In 2004 the fiscal deficit was slightly above 4.3% and further reduces considerably by 0.3% every year.
    - Revenue deficit must be 0 by 2009.It can be achieved by reducing revenue deficit by 0.5% points per annum.
    - Govt should not borrow directly from RBI.
    - Govt has to present the trends of receipts and expenditure in Parliament on a quarterly basis. In case of deviations in receipts and expenditure from the

Fiscal Federalism

- It refers to distribution of resource between centre and states
- Distribution of taxes between centre and states is mentioned in the 7th schedule of our constitution.
- There are 3 lists where the taxes are distributed
    - Union List
    - State List
    - Concurrent List
- Taxes are classified under 5 categories
    - Central taxes or Central Govt. Taxes
    - Shareable taxes – Income tax and Union Excise duty
    - State taxes
    - Taxes imposed and collected by Centre and appropriated by state
    - Taxes imposed by centre but collected and used by state – Stamp duties and agriculture properties.
- This 5 classification arrangement has been amended and the last two categories have now been merged. Now they are called central shareable taxes.
- 10th Finance commission headed by K.C. Pant recommended these amendments.
- By the 80th constitution amendment in 2003, the first two taxes were merged leaving all taxes shareable.

Terminal taxes:-
- Terminal taxes are like platform entry tickets, airport entry tickets for passengers or for goods
- These are collected by the centre and given to the states

Central Taxes:-
- Corporation tax
- Customs duty
- Stamp duties on financial documents
- Wealth tax and gift tax

State Tax
- Sales Tax or Trade Tax
- Excise on liquor and narcotics
- Taxes related to agriculture sector
- Motor spirit and vehicles
- Professional taxes etc.

Finance Commission

- It is a constitution al body constituted as per article 280 by the President of India.
- This commission is constituted after every five years or earlier if required.
- The role of finance commission is to give recommendation as to how the resource should be distributed between centre and states.
- Functions of Finance commission
  - Distribution of tax revenue between Centre and States
  - Principles for how Centre should provide grants to States
  - How to strengthen the Panchayats or municipalities. (added after 73^{rd} and 74^{th} amendment)
  - Any other matter referred to it by President in the interest of Sound Finance.

13^{th} Finance Commission

- The TFC was constituted in terms of the Presidential Order November 13, 2007 to make recommendations relating to tax devolution between the Centre and States; grants-in-aid to States; and measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities.
- In addition to the above, the Commission has also been mandated to review the state of finances of the Union and States, keeping in view, in particular, the operation of the States' Debt Consolidation and Relief Facility 2005-2010 introduced by the Central Government on the basis of the recommendations of the Twelfth Finance Commission, and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth. The Commission submitted its report on December 30, 2009.
- The recommendations of the Commission would be implemented over the period of 2010-15. The FC-XIII's overall approach was to foster "inclusive and green growth promoting fiscal federalism". Observing that as against the level of 75% targeted by the Twelfth Finance Commission, the combined debt-GDP ratio was 82% in the terminal year (2009-10).
- The FC-XIII proposes reducing the combined debt-GDP ratio to 68% by 2014-15 with the Centre's debt-GDP ratio declining to 45%. It recommended a calibrated exit strategy from the expansionary fiscal stance of 2008-09 and 2009-10.
- The FC-XIII has recommended fiscal consolidation through the elimination of revenue deficit as the long-term target for both the Centre and States.
- Terming the goods and services Tax (GST) as a game-changing tax reform measure which will significantly contribute to the buoyancy of tax revenues and acceleration of growth as well as generate positive externalities, the FC-XIII proposed a grand bargain.
- The six elements of the grand bargain for the GST included: 1. the design; 2. operational modalities; 3. Binding agreement between the Centre and States with contingencies for change in rates and procedures; 4. disincentives for non-compliance; 5. the implementation schedule and; 6. the procedure for States to claim compensation.
- For this purpose, the FC-XIII recommended the sanction of Rs 50,000 crore as compensation for revenue losses of States on account of the implementation of the GST.
- This amount would shrink to Rs 40, 000 crore were the implementation to take place on/after April 1, 2013 and further to Rs 30,000 crore were it to take place on/after April 1, 2014.