**INTERNATIONAL INDIAN SCHOOL, JEDDAH**

**STUDY MATERIAL ON MACRO ECONOMICS**

**UNIT-9-Govrnment Budget and the Economy**

**MEANING OF GOVERNMENT BUDGET**: A government budget is a statement showing item wise expected receipts/revenue and expected expenditures under various heads during a fiscal year which runs from April 1 to March 31.

**BUDGET IN OUR CONSTITUTION**: **Article 112** of the constitution of India states that “an annual financial statement” will be placed before both Lok Sabha and Rajya Sabha.Similarly, each state government under **Article 202** is supposed to make an annual financial statement before the legislature of the state, called the budget of the a state government.

**OBJECTIVES/SIGNIFICANCES OF BUDGET**: The objectives that are pursued through the budget are:

* **Redistribution of income and wealth**: Government through fiscal measures of taxation, subsidies and transfer payments try to achieve equal distribution of income. Equitable distribution of income and wealth is a way to bring social justice and remove income inequalities
* **Reallocation of resources**: The government through its budgetary policy reallocates resources so that social and economic objectives are achieved. Private enterprises don’t find it profitable to produce public goods like park,bridges,national defence,etc.Government reallocates its resources and produces these goods which maximizes social welfare.
* **Economic stability**: The government through budget tries to prevent economic instabilities like recession or depression by maintaining price and employment stability. Economic stability increases the inducement to invest and raise the rate of economic growth and development.
* **Managing public enterprises**: The budgetary policy of the government shows interest of the government to increase the rate of growth through public enterprises. Often public sector enterprises are encouraged in areas of natural monopolies. (e.g., water lines, railways etc. where there are advantages if a single firm produces the good and services).

 **COMPONENTS OF THE GOVERNMENT BUDGET**

 There are two components of government budget which are as follows:

* **Revenue budget**: It consists of revenue receipts of the government and the expenditure met from such revenues..
* **Capital budget**: It consists of capital receipts and capital expenditure.

**CLASSIFICTION OF BUDGET RECEIPTS**

 Budget receipts are the estimated total money receipts of the government from all sources during the fiscal year. It has two types’ revenue receipts and capital receipts.

* **Revenue Receipts**: These are the government receipts which neither create liabilities nor lead to e reduction in assets. These include tax revenue and non tax revenue receipts of the government. Tax revenue includes income from corporation tax, income tax, excise duties, sales tax; etc.Non tax revenue includes income from public enterprises, interest and dividends on investment made by the government, fees receipts, fines and penalities, etc.
* **Capital Receipts**: These are the government receipts which either create liabilities or lead to reduction in assets.These include loans raised by the government from the public. These are called market loans, loans received from foreign government and foreign bodies(IMF,WORLD BANK,etc.),recoveries of loans granted to state and union territory government and other parties, small savings and deposits in PPF,etc.

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

**MEANING OF TAX**: A tax is a legally compulsory payment imposed on the people by the government.

**Types of Taxes**: Taxes are of two types, i.e., Direct taxes and Indirect taxes.

* **Direct Taxes**: These taxes are imposed on the property and income of persons or firms and are paid directly by the persons on which they are imposed. Income tax, weath tax and corporation tax are examples of direct taxes. In case of such taxes the liability of payment to the government and the actual burden of tax lie on the same person. Direct taxes are not shiftable.
* **Indirect Taxes**: These taxes are levied on the production and sale of the commodities. The liability of payment to the government lies on one person (seller) while the actual burden of tax lies on the other person (buyer).Examples of indirect taxes are sales tax, excise duties, custom duties,etc.Indirect taxes are not shiftable.

**CLASSIFICATION OF BUDGET EXPENDITURE**: It is the expenses which the government incurs for its own maintenance as also for the society and the economy as a whole.It is classified into following heads:

**Plan Expenditure**: It is the expenditure to be incurred during the years on the programmes under the current five year plan. It is incurred on financing the central plan relating to different sectors of an economy.

**Non-Plan Expenditure**: All those expenditures other than the expenditure related to the current five year plan is known as non-developmental expenditure. Examples are interest payment,defence services expenditure,subsidies,education and health services, flood control etc.

**Revenue Expenditure**: These are those expenditures of the government which neither create assets nor lead to reduction in liabilities. Such expenditures are incurred for normal running of government departments and maintenance of services. For example,salaries,pensions,interest payments,subsidies,grants,etc.

**Capital Expenditure**: These are those expenditures which lead to creation of assets or reduce government liabilities. For example, expenditure on purchasing land,building,shares,etc.It also includes loans granted to the state and union territories, foreign governments, public enterprises and other parties. Repayment of loan is also a capital expenditure because it reduces the liabilities of the government.

**Developmental Expenditure**: All those expenditure on activities which are directly related to economic and social development of a country are called developmental expenditure. For example: expenditure on agriculture and industrial development,education,health,social welfare,scientific research,etc.

**Non-Developmental Expenditure**: Expenditure on essential general services of the government is called non-developmental expenditure. For example: expenditure on defense and administration, interest payments, collection of taxes, etc.These expenditure are an essential part of development process. While it does not directly contribute to the national product but lubricates the wheel of economic development.

**Balanced Budget**: It is one where the estimated revenue is equal to estimated expenditures. This kind of budget leads to slight increase in AD.A balanced budget is a good policy to bring the economy which is at underemployment to full employment equilibrium. But it is not good for a developing country like India where government should have more expenditures than revenue which will rise AD.

**Unbalanced Budget**: In this, receipts are not equal to expenditures of the government. It is of two types:

* **Surplus Budget**: It is one where estimated revenues are more than estimated expenditures. It lowers AD. It is a good policy to control inflation where the economy is in over employment equilibrium due to excess demand.
* **Deficit Budget**: It is one where estimated revenues are less than estimated expenditures. It increases AD. It is a good policy to control recession when an economy is in an under-employment equilibrium level.

**MEANING OF REVENUE DEFICIT AND ITS IMPLICATIONS**: It refers to the excess of total revenue expenditure over total revenue receipts. It is calculated as:

**Revenue Deficit**= Revenue Expenditure-Revenue Receipts

**Implications of revenue deficit**: There are two implications for revenue deficit. Firstly, a part of revenue is deficit is financed through borrowed funds from the capital account. This implies that governments’ investment or capital expenditure is reduced to the extent of deficit on the revenue account. This affects economic growth of the economy.Secondly, because of high revenue deficit, government has to borrow from the market which reduces the available resources for private investment. This again lowers the economic growth of the economy.

**MEANING OF FISCAL DEFICIT AND ITS IMPLICATIONS**: It is defined as the excess of all expenditure over total receipts net of borrowings. Fiscal deficit doesn’t take into account borrowings. In terms of formula,

 Fiscal Deficit= Total budget expenditure –Total budget receipts net of borrowings

**Implications of Fiscal deficit**: Fiscal deficit is in fact equal to the total borrowings and other liabilities of the government.A large fiscal deficit thus imply a large amount of borrowings. This creates a correspondingly large burden of interest payments in the future. Large fiscal deficit may also lead to inflationary pressure in the economy.

**Difference between Budget deficit and Fiscal deficit**: fiscal deficit doesn’t into account all types of receipts. It does not take into account borrowings whereas budget deficit take in to account borrowings as well.

**MEANING OF PRIMARY DEFICIT AND ITS IMPLICATIONS**: It is the excess of fiscal deficit over interest payments on the public debt. In terms of formula,

 **Primary deficit** = Fiscal deficit- Interest payments

**Implications for primary deficit**: Primary deficit indicates how much government borrowings are required to meet its existing expenses other than interest payments on public debt. A zero primary deficit means that the government has to resort to borrowing only to meet its interest payments on public debt. It is not adding to the existing loans.

**MEASURES TO CORRECT DIFFERENT DEFICITS:** A deficit may be financed by the following ways:

* Monetary expansion or deficit financing
* Borrowing from the public
* Disinvestment
* Lowering government expenditure
* Raising government revenue