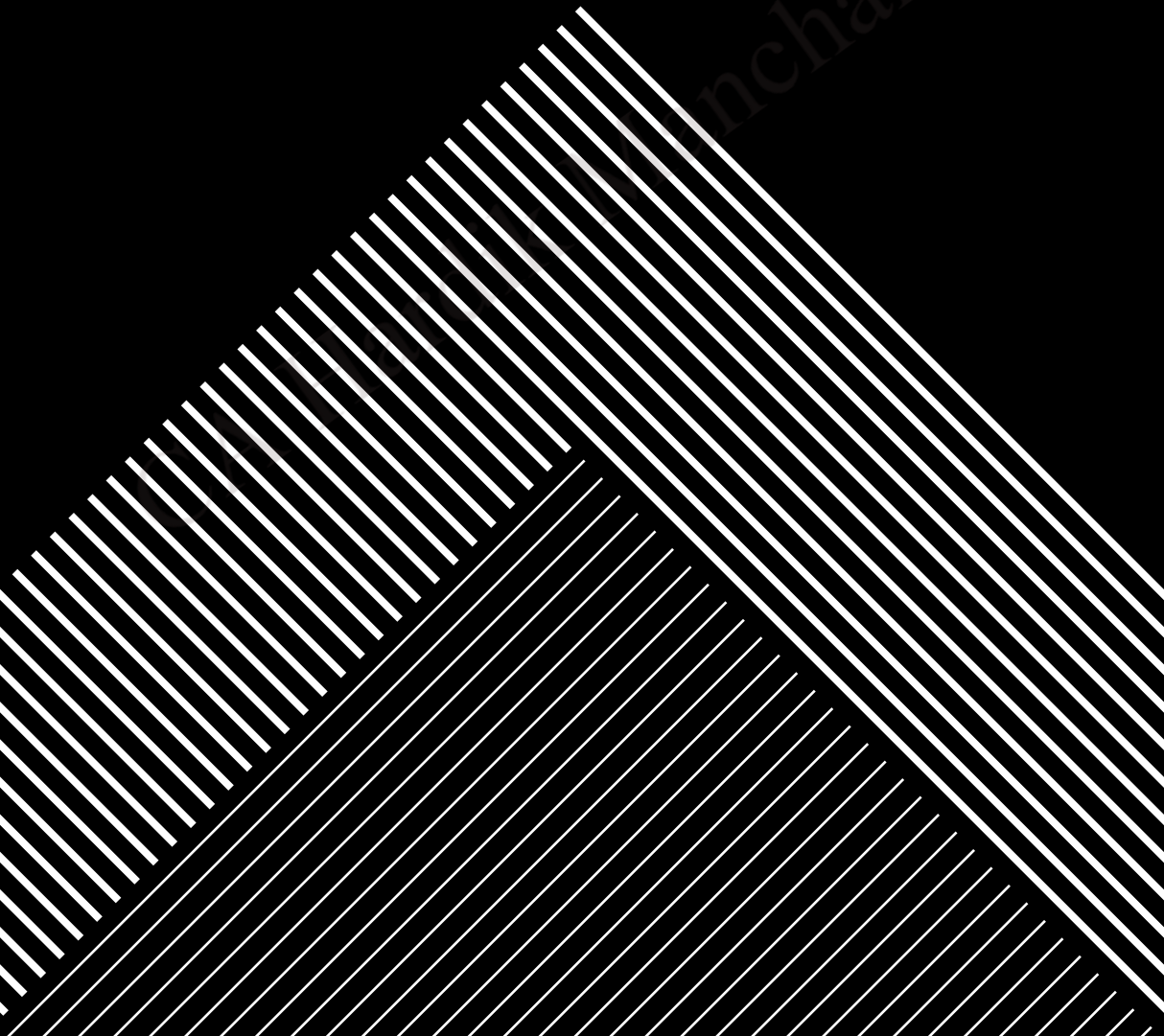




UNIT – 3: THE PROCESS OF BUDGET MAKING: SOURCES OF REVENUE, EXPENDITURE MANAGEMENT AND MANAGEMENT OF PUBLIC DEBT



Introduction

- The need for budgeting arises from the need to efficiently allocate limited resources to ensure maximum social welfare.
- The government also needs to reallocate resources in accordance with its declared priorities.
- By proper budgeting, the government is able to ensure redistribution of income and wealth.
- The other objectives of budgets are:
 - 🎯 reduction/elimination of economic fluctuations to bring in stability,
 - 🎯 sustainable increase in real GDP and reduction in regional disparities.

- **Budget** is a statement that presents the details of 'where the money comes from' and 'where the money goes to':
 - A government budget is a schedule of the entire revenues and expenditures that the government expects to receive and plans to spend during the following year.
 - The budget includes projections for the economy and its various sectors such as agriculture, industry, and services. The budget also contains estimates of the government's accounts for the next fiscal year called budgeted estimates. *exp.*
 - Being the document which consolidates revenues from all sources and outlays for all activities, the budget is the most comprehensive report of the government's finances.
 - Apart from the union budget, state and the local bodies have their own budgetary processes for the next financial year



The Process of Budget Making

- The finances of the government of India have traditionally been controlled by the **Ministry of Finance**. The budget is prepared by the Ministry of Finance in consultation with **NITI Aayog** and other relevant ministries.
- The budget must be presented and approved by both houses of parliament before the beginning of the fiscal year (April 1 to March 31).
- Despite the fact that the term 'budget' has not been used in the Indian Constitution, the process of making it is generally referred to as budgeting. **Article 112 of the constitution** provides that in respect of every financial year the **president shall cause to be laid before both the houses of parliament a statement of the estimated receipts and expenditure of the government of India for that year, referred to as the "Annual Financial Statement"**.

Budgetary Procedures

Preparation of Budget



Presentation and enactment of the budget



Execution of Budget

The budget process mainly consists of two types of activities:

1. The **administrative process**, wherein the budget along with the accompanying documents are prepared in consultation with various stakeholders;
2. The **legislative process** wherein the **budget is passed by the parliament** after discussions.

Despite the fact that the union **budget is presented on 1st February** (or any other suitable date as decided by the government), **the process of budget preparation commences in August-September of the previous year.**

The **Budget Division of the Ministry of Finance** prepares a comprehensive schedule for carrying out the budget preparation activities.

The process of budget making

Set off with the Budget Division issuing the budget circular containing detailed instructions and formats for preparing the estimates to all ministries, states, union territories and autonomous bodies.

■ The detailed estimates of expenditure are prepared by ministries and departments according to their assessment of requirements for the subsequent year. Every department prepares estimates for receipts and expenditure separately.

A series of pre-budget consultations are done by the union finance minister with the finance ministers and chief ministers of states, various stakeholders and interest groups including industry associations, representatives from agriculture and social and welfare sectors, labour organisations, experts from NITI Aayog, economists etc. to obtain their suggestions on the proposed budget.

Budget Documents

Broadly, depicts information relating to **receipts and expenditure for two years**. They are:

- (i) **Budget estimates (BE)** of receipts and expenditure in respect of **current and ensuing financial year** *following*
- (ii) For the **current year** through **Revised Estimates (RE)**; and
- (iii) **Actuals of the year preceding the current year** 23-24

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Budget Speech

- The budget speech is mainly a policy document which draws attention to the **proposed policies and programmes of the government**.
- The finance minister makes a detailed budget speech at the time of presenting the budget **before the Lok Sabha**.
- The budget speech present details of the proposals for the new financial year regarding **taxation, borrowings and expenditure plans** of the government.

The budget speech of the Finance Minister is usually in two parts:

Part A of the budget speech gives an outline of the **Existing prevailing macro economic situation of the country and the budget estimates for the next financial year**.

Elaborating the priorities of the government, the minister presents a broad framework of the **total funds raised by the government** via taxes or borrowings, proposed government expenditure allocations for different sectors and fresh schemes for different sectors.

Part B of the budget speech details the **progress the government has made on various developmental measures, the direction of future policies and the government's tax proposals for the upcoming financial year including variations in the current taxation system**.

Budget

The Annual Financial Statement shows the receipts and expenditure of government in three separate parts under which government accounts are maintained, namely:

1. Consolidated Fund of India

- All revenues received, loans raised and all moneys received by the government in repayment of loans are credited to the Consolidated Fund of India and all expenditures of the government are incurred from this fund.
- Money can be spent through this fund only if appropriated by the parliament. The consolidated Fund has further been divided into 'revenue' and 'capital' divisions.

2. Contingency Fund of India

- A fund placed at the disposal of the President to enable him/her to make advances to the Government to meet urgent unforeseen expenditure.
- Contingency fund enables the government to meet unforeseen expenditure and does not require prior legislative approval, unlike with the Consolidated Fund.
- For meeting such exigencies, advances are made to the government from the contingency fund which is subsequently reported to the Parliament for recoupment from the Consolidated Fund of India.

3. Public Account

- Under provisions of Article 266(1) of the Constitution of India, public account is used in relation to all the fund flows where government is acting as a banker.
- Examples include Provident Funds and Small Savings. This money does not belong to government but is to be returned to the depositors.
- The expenditure from this fund need not be approved by the parliament.

The list of budget documents presented to the parliament, besides the finance minister's budget speech, is given below:

(a) Annual Financial Statement (AFS) - Budget

(b) Demands for Grants (DG)

(c) Finance Bill ✓

(d) Statements mandated under FRBM (Fiscal Responsibility & Budget Management) Act:

i. Macro -Economic Framework Statement

ii. Medium-Term Fiscal Policy cum Fiscal Policy Strategy Statement

Nine other documents which are in the nature of explanatory statements supporting the mandated documents are also presented along with the documents mentioned above.

Expenditures charged on Consolidated Fund of India

The expenditures of certain categories like:

- The emoluments and allowances of the President of India and his/her office, and
 - Emoluments of Judges of supreme courts and high ranking personnel of constitutional bodies across India,
- are not subject to the vote of parliament and are indicated separately in the budget.

By convention in an election year, the budget may be presented twice.

- The first one is to first secure a Vote on Account for a few months.
- followed by the Annual financial statement for that year or the full-fledged Budget.

The budget is discussed in two stages in the Lok Sabha:

- First, there is the general discussion on the budget as a whole.
- After the first stage of general discussion on the union budget is over, the house is adjourned for a fixed period. During this period, the demands for grants of various ministries/ departments are considered by the standing committees concerned, and once the reports are presented by these committees within the stipulated time, the house proceeds to discussion and conducts ministry-wise voting on demands for grants.
- The Lok Sabha has the power to concur or to refuse any demand or even to reduce the amount of grant sought by government.
- Motions for reduction to various demands for grants are made in the form of 'cut motions' seeking to reduce the sums sought by government.
- The budget is laid on the table of the Rajya Sabha soon after the Finance Minister has completed her/his budget speech in the Lok Sabha. The Rajya Sabha, does not vote on the demands for grants and there is only a general discussion on the budget.
- After the general discussion on the budget proposals and voting on demands for grants have been completed, the government introduces the Appropriation Bill.
- The Appropriation Bill is intended to give authority to government to incur expenditure from and out of the Consolidated Fund of India.
- On the last day of the 26 days allotted for discussion on the demands for grants, the speaker puts all the outstanding demands for grants to the vote of the house. This process is known as 'Guillotine'. It is a device for bringing the debate on financial proposals to an end within a specified time.

FINANCE BILL

- The Finance Bill seeking to give effect to the **government's taxation proposals** is introduced in **Lok Sabha** immediately after the presentation of the general budget.
- It is accompanied by a **memorandum** explaining the provisions of the bill and their effect on the finances of the country.
- The motion for leave to **introduce** a finance bill **cannot be opposed**.
- **The finance bill is taken up for consideration and passing after the Appropriation Bill is passed.**
- **The Parliament has to pass the Finance Bill within 75 days of its introduction.**
- After the Finance Bill has been passed by the Lok Sabha, it is transmitted to the **Rajya Sabha** for its recommendations. The bill being a money bill, **Rajya Sabha has to return it within a period of 14 days**, with or without recommendations. **The recommendations of Rajya Sabha may be accepted or rejected by the Lok Sabha.**

However from **2017-18**, the date of presentation of the budget has been advanced to **1st February**. **An important budgetary reform was the merger of railway budget with the general budget from the budget for financial year 2017-18.**

Source of Revenue

- The Department of Revenue of the Ministry of Finance exercises control in respect of the revenue matters relating to direct and indirect union taxes.
- The department is also entrusted with the administration and enforcement of regulatory measures provided in the enactments concerning goods and services tax (GST), central sales tax, stamp duties and other relevant fiscal statutes.
- The Department of Revenue exercises control in respect of matters relating to all the direct and indirect union taxes through two statutory boards, namely,
 1. the Central Board of Direct Taxes (CBDT) - Matters relating to the levy and collection of all direct taxes are looked after by the CBDT
 2. the Central Board of Indirect Taxes and Customs (CBIC)- Matters relating to levy and collection of goods and service taxes (GST), Customs and central excise duties, service tax and other Indirect taxes fall within the purview of the CBIC.

Government receipts are classified under two categories:

1. **Revenue receipts** which consists of tax revenue and non tax revenue.
2. **Capital receipts** which consists of debt receipts and non debt capital receipts



Capital receipts are those receipts that lead to a reduction in the assets or an increase in the liabilities of the government

The broad sources of revenue are:

1. Corporation tax
2. Taxes on income
3. Wealth tax ✕
4. Customs duties
5. Union excise duties
6. Goods and services tax including GST compensation cess
7. Taxes on union territories

Centre's net tax revenue is the total of tax revenue after paying of the states' share and the National Calamity Contingent duty (NCCD) transferred to the **National Calamity Contingency**.

Centre's net tax revenue = Total tax revenue - state's share - NCCD

— Revenue Receipt

Non-tax revenues comprise the following:

1. Interest receipts,
2. Dividends and profits from **public sector enterprises** and **surplus transfers from Reserve Bank of India**
3. Other Non-tax revenues and
4. Receipts of **union territories**

Various **social services** provided by the government such as medical services, public health, broadcasting, education, sports, art and culture, housing and **economic services** such as communication, energy, transport, science, technology and environment, railways and general administrative services **also yield revenue for the government**.

Capital Receipts include:

1. **Non debt capital receipts** which include
 - (a) **Recoveries of loans** advanced by the government to **PSEs, state governments, foreign governments** and **union territories**
 - (b) **Miscellaneous capital receipts** (disinvestments and others) - **sale proceeds of government assets**, including those realized from divestment of government equity in public sector undertakings (PSUs).

2. **Debt capital receipts** which include

- (a) Market loans for different purposes
- (b) Short term /Treasury bill borrowings
- (c) Securities issued against **small savings**, **NSC**.
- (d) State provident fund (Net)
- (e) Net external debts
- (f) Other receipts (Net) - **Sovereign Gold Bond Scheme**, receipts from international financial institutions and saving bonds.

Public Expenditure Management

- Developing economies like India require enormous amount of public spending to initiate and accelerate economic growth and to promote employment opportunities.
- **Effective reduction in fiscal deficit requires an ingenious mix of revenue and expenditure policies.**
- Government expenditure affects allocation of resources among various uses and therefore, great care should be taken to channelize the resources to socially desirable areas.
- **Public expenditure management** is the process that allows governments to be fiscally responsible. Public expenditure programmes or projects should be designed and implemented to provide given levels of outputs or achieve specific objectives at minimum cost.

The **economic costs of unproductive public expenditures** can be extensive and may have far reaching effects such as:

- larger deficits $Exp > Rev.$
- higher levels of taxation,
- lower economic growth,
- fewer resources available for use elsewhere, and
- greater debt burden in the future.

The **Department of Expenditure** of the Ministry of Finance is the nodal department for overseeing the public financial management system in the central government and matters connected with state finances. It is responsible for

- the implementation of the recommendations of the Finance Commission and the Central Pay Commission, for Govt employee.
- monitoring of audit comments/observations, and
- preparation of central government accounts.
- Additionally, it also assists central ministries/departments in controlling the costs and prices of public services,
- reviewing systems and procedures to optimize outputs and outcomes of public expenditure.

main
Govt — CAG
Audit

- The requirements of funds for all categories of expenditure including various programmes and schemes, along with receipts of the departments are discussed during the pre-budget meetings chaired by Secretary (Expenditure).

- Expenditure estimates are provisionally finalised and communicated to ministries/ departments after the approval of Finance Minister.

- One of the explanatory documents of the budget document is the 'Expenditure Profile' (earlier known as expenditure budget) consisting of relevant data across all ministries/departments to outline a profile of the general financial performance of the government of India. It gives an aggregation of various types of expenditures.

The total expenditure through budget of various ministries and departments is composed of central expenditure and transfers. In Expenditure budget, **the Central government expenditure is classified into six broad categories** as below:

A. **Centre's Expenditure:**

- Establishment Expenditure of the Centre; Administration
- Central sector schemes, and fully funded by CG
- Other central expenditures including those on CPSEs (**central public sector enterprises**) and **Autonomous Bodies**

B. **Centrally Sponsored Schemes and other Transfers:**

The transfers include

- **Centrally sponsored schemes**
- **Finance Commission transfers** and
- Other **transfers to states**

Public Debt Management

- In emerging market and developing economies, **the government is generally the largest borrower.**
- Government debt from internal and external sources contracted in the Consolidated Fund of India is defined as **Public Debt.**
- The government raises funds primarily from the domestic market using **market-based and fixed-rate instruments** to finance its fiscal deficit.
- Public debt, in simple words, means **debt incurred by the government in mobilizing savings of the people in the form of loans, which are to be repaid at a future date with interest.**
- Public debt is **not a one-time exercise** of borrowing and repaying. **Debt servicing is a continuous exercise** as a portion of debt falls due each month, government does not usually cut expenditure or raise taxes to provide funds to retire or repay the maturing bonds. Rather, **the government simply refinances the debt**, i.e. it sells new bonds and uses the proceeds to pay off holders of the maturity bonds.
- Hence public debt management becomes a crucial task or responsibility of the government and plays an important role in **macroeconomic stability of a country.**
- **Debt sustainability is in great part a function of the level of debt and the government's capacity to service the outstanding debt.**

- Public debt management refers to the task of **determining, by the fiscal and monetary authorities, the size and composition of debt, the maturity pattern, interest rates, redemption of debt etc.**
- It is the process of setting up and implementing the strategy for managing public debt in order to **raise the required amount of funding at the desired risk and cost levels.**

The overall objective of the central government's debt management policy is to "meet the central government's financing needs at the lowest possible long term borrowing costs and also to keep the total debt within sustainable levels. Additionally, it aims at supporting development of a well-functioning domestic bond market".

Debt management strategy is based on three broad pillars namely:

- ☞ low cost of borrowing,
- ☞ risk mitigation and
- ☞ market development.

Loan - \$1000,

14/12 - 1\$ = ₹82

↳ $1000 \times 82 = 82000$

31/3/24 - 1\$ = ₹84

↳ 84000

The institutions responsible for public debt management are:

1. Reserve Bank of India - domestic marketable debt i.e., dated securities, treasury bills and cash management bills.
↳ long term
2. Ministry of Finance (MOF); - external debt
3. Ministry of Finance; Budget Division and Reserve Bank of India - Other liabilities such as small savings, deposits, reserve funds etc.

PF, NSC

RBI

■ The responsibility of managing the domestic debt of the central government and of 28 state governments and two union territories is entrusted with the Internal Debt Management Department (IDMD) of the Reserve Bank of India.

■ While treasury bills are issued to meet short term cash requirements of the government, dated securities are issued to mobilise longer term resources to finance the fiscal deficit.

■ From 1997 onwards, the Reserve Bank also provides short-term credit up to three months to state governments banking with it in the form of Ways and Means Advances (WMA) to bridge temporary mismatches in cash flows.



Loan from 1 country →
 Group of countries → ADB

- External debt (bilateral and multilateral loans) is managed by the Department of Economic Affairs in the Ministry of Finance (MoF).
- Most of the external debt is sourced from multilateral agencies (International Bank for Reconstruction and Development, Asian Development Bank, etc.).
- There is ^{Govt} no sovereign borrowing from international capital markets. The entire external debt, in terms of original maturity, is on long-term basis and a major part is at fixed interest rates.
- The risk associated with external debt is the depreciation in the value of the domestic currency i.e., the currency of denomination of external loans leading to increase in the government's debt servicing cost.
 $1\$ = 82 \rightarrow 1\$ = 784$] Depreciation

The Fiscal Responsibility and Budget Management (FRBM) was passed in 2003 to provide a legislative framework for reduction of deficit and thereby debt of the central government to a sustainable level. The objectives of the act are:

- inter-generational equity in fiscal management,
- long run macroeconomic stability,
- better coordination between fiscal and monetary policy, and
- transparency in fiscal operation of the government.

The Public Debt Management Cell (PDMC) was created in 2016 under the Department of Economic Affairs.

- The Medium Term Debt Management Strategy or MTDS 2021-24 is a framework to determine the appropriate composition of the debt portfolio.
- The objective of the debt management strategy is to efficiently raise debt at the lowest possible cost in the medium term while ensuring that financing requirements are met without disruption.

During Pandemic

- In line with the global trend, the government of India also responded to the pandemic challenges and **increased its expenditure on health and social sector**. At the same time, the **revenue receipts declined** substantially due to the adverse effects of the pandemic on economic activity.
- Consequently, **fiscal deficit widened** necessitating an increase in the size of the borrowing programme significantly during **2020-21** and **2021-22** in order to render **counter-cyclical fiscal policy support** and to provide targeted support to segments deeply hit by the pandemic.

The Reserve Bank has been proactively engaged in the development of the **government securities (G-sec)** market **including broadening of investor participation**. As part of continuing efforts to increase retail participation in G-sec, '**RBI Retail Direct**' facility was announced on **February 5, 2021**:

- for **improving the ease of access by retail investors** through online access to the primary and secondary government securities market
- to provide the **facility to open their government securities account** ('Retail Direct') with the Reserve Bank.

Important Budget Concepts

Type of budgets

■ **Balanced budget:** - A balanced budget is a budget in which **revenues are equal to expenditures**. Thus, **neither a budget deficit nor a budget surplus exists**.

Revenue = Expenditure

■ **Unbalanced budget:** The budget may either be surplus or deficit

☞ **A surplus budget:** when **estimated government receipts are more than the estimated government expenditure** it is termed as surplus budget.

Public revenue exceeds Public expenditure ($R > E$.)

☞ **A deficit budget:** when **estimated government receipts are less than the government expenditure**, it is termed as a deficit budget.

A deficit budget increases the liability of the government or decreases its reserves.

In modern economies, **most of the countries follow deficit budgeting**.

Revenue Expenditure : Revenue expenditure is **expenditure incurred for purposes other than creation of physical or financial assets of the central government**. It relates to those expenses incurred for the **normal functioning of the government departments** and various services.

■ **interest payments on debt incurred by the government, and grants given to state governments and other parties**

Capital Expenditure: There are expenditures of the government which **result in creation of physical or financial assets or reduction in financial liabilities**.

■ This includes expenditure on the acquisition of land, building, machinery and equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties.

Loan - ₹100 — Int on Loan - Rev exp
↳ Repay, Cap Exp

Budgetary Deficit or Overall Deficit

Budgetary Deficit is defined as the **excess of total estimated expenditure over total estimated revenue**, both revenue and capital.

Revenue Deficit

■ The revenue deficit refers to the **excess of government's revenue expenditure over revenue receipts**.

■ It shows the shortfall of government's ^{Revenue} current receipts over current expenditure. It shows the government revenue is insufficient to meet the regular expenditures in connection with the normal functioning of the government. Revenue

Revenue deficit = Revenue expenditure - Revenue receipts

Fiscal Deficit

When the government's **non-borrowed receipts** fall short of its entire expenditure, it has to borrow money from the public to meet the shortfall. **The excess of total expenditure over total receipts excluding borrowings** during a given fiscal year is called the fiscal deficit.

☞ It is often presented as a **percentage of the gross domestic product (GDP)**.

■ **Total Receipts excluding borrowing** = Revenue Receipts + Capital Receipts **excluding borrowing** or **(Non debt creating capital receipts)**.

☞ Non debt creating capital receipts include recoveries of loans advanced by the government and sale proceeds of government assets, including those realized from **divestment of government equity in public sector undertakings (PSUs)**.

■ **Fiscal deficit = Total Expenditure - Total Receipts excluding borrowing**

Fiscal Deficit = (Revenue Expenditure + Capital Expenditure) - (Revenue Receipts + Capital Receipts excluding borrowing)

Fiscal Deficit = (Revenue Expenditure - Revenue Receipts) + (Capital Expenditure - Capital Receipts excluding borrowing)

■ **Fiscal Deficit = Revenue Deficit + (Capital Expenditure - Capital Receipts excluding borrowing)**

Rev. Cap
 \ /



The fiscal deficit will have to be financed by borrowing.

■ Therefore **fiscal deficit points to the total borrowing requirements of the government from all sources.**

■ In case revenue deficit occupies a substantial share of fiscal deficit, it is an indication that a large part of borrowing is used for consumption purposes rather than for investment.

Rev Exp

Primary Deficit

Primary deficit is defined as **fiscal deficit of current year minus interest payments on previous borrowings.**

■ In other words whereas fiscal deficit indicates borrowing requirement inclusive of interest payment, primary deficit indicates borrowing requirement exclusive of interest payment.

■ It tells **how much of the government's borrowings are going towards meeting expenses other than interest payments.**

■ Primary deficit thus gives an estimate of borrowings on account of current expenditure exceeding current revenues.

Primary deficit = Fiscal deficit - Net Interest liabilities

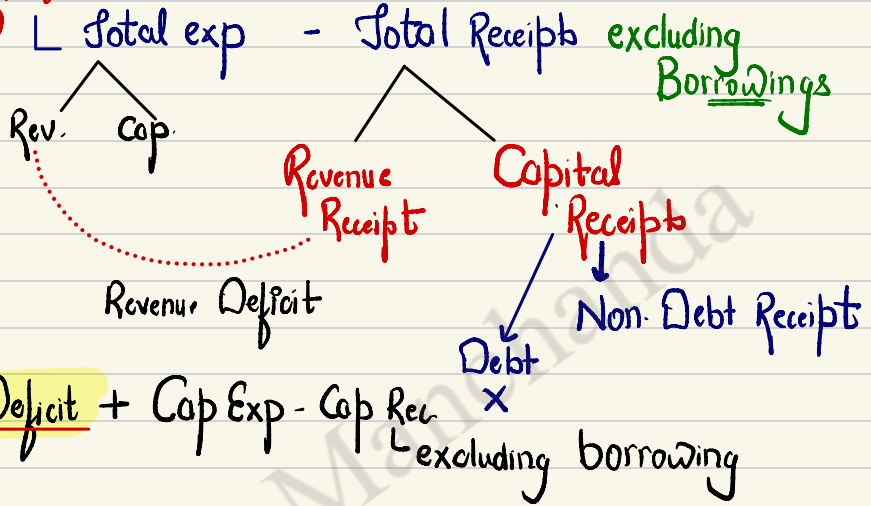
Net interest liabilities interest payments minus interest receipts by the government on domestic lending.

Outcome budget

■ The outcome budget **establishes a direct link between budgetary allocations of schemes and its annual performance targets measured through output and outcome indicators.**

■ The outcome budget is a **progress card on what various ministries and departments have done with the ^{Exp}outlays in the previous annual budget.** It measures the development outcomes of all government programs and whether the money has been spent for the purpose it was sanctioned including the outcome of the fund usage.

Fiscal Deficit



→ Rev Deficit + Cap Exp - Cap Rec_{excluding borrowing}

eg = Total Revenue [excluding borrowings] = ₹100

Total Govt exp = ₹150

Interest payment = ₹30
[Rev Exp]

→ Fiscal Deficit = 150 - 100 = ₹50

eg. Primary Deficit

Exp (excluding Int) = ₹120 (150 - 30)

Rev. = ₹100

Primary Def = ₹20