Economics Class 22

BUDGET (09:00 AM)

- **Components of Budget:**
- The budget primarily consists of 2 components such as receipts and expenditures.
- The receipts are further classified into revenue receipts and capital receipts whereas the expenditure is further classified into - Revenue expenditure and capital expenditure.
- **Revenue Receipts**:
- These receipts do not lead to a claim against the govt i.e. they neither create a liability nor decrease an asset for the government.
- They can further be divided into tax and non-tax revenues.
- **Tax receipts** can be further divided into direct taxes like personal income tax, corporate tax, etc and indirect taxes like excise, customs, and GST.
- **Non-Tax revenues** of the central govt consist of interest receipts on account of loans given by the central govt, dividends and profits on investments made by the govt, fees and other receipts for services rendered by the govt, grants in aid from foreign countries, international organisation, receipts related to social services, economic services, general services, etc are also included along with profits on fiscal services, etc.
- **Capital Receipts:**
- All those receipts from the govt which create liability or reduce assets are termed capital receipts.
- These receipts can be debt-creating (borrowings) or non-debt-creating (disinvestment, loans recovered).

- **Revenue Expenditure:**
- It is the expenditure incurred for purposes other than the creation of physical or financial assets.
- This expenditure relates to the expenses incurred for the normal functioning of the govt including maintenance of law and order, interest payments, salaries and pensions paid, grants given to state govt and other parties, subsidies given, postal deficit, expenditure on social services, general services, economic services etc.
- **Capital Expenditure:**
- These are expenditures of the govt which result in the creation of physical or financial assets or a reduction in financial liabilities.
- This includes expenditure on the acquisition of land, buildings, machinery, equipment, investment in shares, loans given by central govt to states and UTs and also loans repaid.

TYPES OF DEFICITS (09:55 AM)

- **Revenue Deficit (RD):** It is the excess of government revenue expenditure (RE) over revenue receipts (RR).
- Therefore it indicates that govt cannot meet its current expenditure from its current revenue.
- RD = RE - RR
- RD is seen as the most dangerous form of the deficit as it can lead to the reduction of existing assets or an increase in govt liabilities.
- RD is usually represented as a percentage of the GDP.
- 2023-24 budgetary estimate target of RD is 2.9% of GDP.

- **Budgetary Deficit (BD):**
- It is an overall deficit and is currently not used for policymaking.
- It is the excess of total expenditure over total revenues.
- BD includes both revenue and capital items mentioned in the receipts and expenditures.
- BD is financed either through borrowings, taxes or printing money.
- But govt has largely relied on borrowings for financing the budgetary deficits leading to an increase in govt debt.

Fiscal Responsibility and Budget Management

- **Effective revenue deficit (ERD)**
- It was introduced after 2012, after the changes in FRBM Act 2003.
- ERD is nothing but a Revenue deficit minus the grants given by the central government to states and UTs for capital purposes.
- **Fiscal Deficit (FD):**
- The difference between the govt total expenditure and total receipts excluding borrowings.
- FD = Total expenditure - (Revenue Receipts + Non-Debt Creating Capital Receipts).
- Non Debt creating capital receipts are those which do not increase the debt of govt (loans recovered, disinvestment).
- RD is also a part of the fiscal deficit.
- FD = RD + Capital Expenditure - (Non-Debt Creating Capital Receipts).
- FD is financed by borrowings, therefore it also indicates the total borrowings of the govt.
- If there is a large share of RD in the total fiscal deficit, it means that a large part of the borrowings is being used to finance the consumption requirements (not good for the country).

- **Primary Deficit (PD)**
- It is defined as FD minus the interest payments
- PD excludes the burden of previous debt and shows the net increase in government debts i.e. due in the current fiscal year.
- 2023-24 budgetary PD Target- 2.3 % of GDP.

FRBM ACT (11:11 AM)

- FRBM Act is a law enacted by the government in 2003 to ensure Fiscal discipline by setting targets including the reduction of FD and elimination of Revenue Deficit (RD).
- In India, the borrowing levels were very high in the 1990s and 2000s. The Indian economy was weak as it had high FD, high RD, and a high Debt/GDP ratio.
- By 2003, continuous government borrowings and resultant debt had severely impacted the health of the Indian economy.
- Much of the borrowing was utilized for interest payments on previous borrowings but not for productive purposes.
- This can push India into a **debt trap,** And therefore a Bill was passed by the Indian parliament in 2003 which laid the foundation for the Fiscal Responsibility and Budget Management Act 2003 (FRBM Act).
- FRBM Act had to focus on Fiscal Discipline, Macroeconomic stability, effective management of expenditure, revenue, and debt, better coordination between Fiscal policy and monetary policy, and also to bring transparency in the Fiscal operation of the government.

INITIAL TARGETS OF FRBM ACT TILL 2008-09 (11:50 AM)

- **Revenue deficit target**- RD should be eliminated by March 31st, 2009. The minimum annual reduction target was 0.5% of the GDP.
- **Fiscal deficit target-** FD should be reduced to 3% of GDP by March 31st, 2009, the minimum annual reduction target was 0.3% of GDP.
- **Contingent liabilities**- The central government shall not give incremental guarantees aggregating an amount exceeding 0.5% of GDP in any financial year beginning from 2004-05.
- **Additional liabilities**- Additional liabilities including external debt should be reduced to 9% of GDP by 2004-05.
- RBI's purchase of government bonds to cease from 1st April 2006. This indicates government can not borrow directly from RBI.
- Due to the global financial crisis, the government resorted to Fiscal stimulus, and therefore FRBM targets were temporarily postponed.

TOPIC OF THE NEXT CLASS- DISCUSSION ON FRBM ACT (TO CONTINUE)