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SUMMARY SHEET

Fiscal Policy Since Reforms of 1991

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NABARD Grade A 2021

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Contents

1 Part 1: Basics of Budget 3
1.1 Introduction to Budget 3
2 Part 2: Basics of Fiscal Policy 4
2.1 Meaning of Fiscal Policy 4
2.2 Types of Fiscal Policy 5
2.3 Tools of Fiscal Policy 5
2.4 Similarities & Difference between Monetary Policy and Fiscal Policy 5
2.4.1 Similarities 5
2.4.2 Differences 6
3 Part 3: Components of Budget 6
3.1 Receipts 6
3.1.1 Revenue Receipts 7
3.1.2 Capital Receipts 8
3.1.3 Distinction between Debt Creating Capital Receipts and Non-Debt Creating Capital Receipts 9
3.1.4 Distinction between Revenue Receipt and Capital Receipt 10
3.2 Expenditure 10
3.2.1 Revenue Expenditure 11
3.2.2 Capital Expenditure 11
3.2.3 Difference between Revenue Expenditure and Capital Expenditure 12
4 Part 4: Balanced, Surplus & Deficit Budget 13
4.1 Balanced Budget 13
4.2 Surplus Budget 13
4.3 Deficit Budget 14
5 Part 5: Types of Budgets in India 14
5.1 Zero-Base Budgeting 14
5.2 Gender Budgeting 14
5.2.1 What is Gender Budgeting? 15
5.3 Outcome and Performance Budgets 15
6 Part 6: Measures of Government Deficit 15
6.1 Revenue Deficit 16
6.2 Effective Revenue Deficit 16
6.3 Gross Fiscal Deficit 16
6.4 Net Fiscal Deficit 17
6.5 Gross Primary Deficit 18
6.6 Net Primary Deficit 18
6.7 Traditional Budget Deficit 18

6.8 Monetized Deficit 18
6.9 Significance of Different Measures of Deficit 18
6.9.1 Fiscal Deficit 18
6.9.2 Budget Deficit 19
6.9.3 Monetized Deficits 19
6.9.4 Primary Deficits 19
6.9.5 Revenue Deficit 19
6.10 Deficit Financing 19
7 Part 7: Public Debt in India 20
7.1 Borrowings by the Centre and the States – Constitutional Provisions 20
7.2 Internal Debt 20
7.3 External Debt 21
7.4 Fiscal Responsibility & Budget Management Act 2003 21
8 Part 8: GST: One Nation, One Tax, One Market (Linked to Tax Revenue) 22
8.1 What is Central Goods and Services Tax (CGST)? 23
8.2 What is State Goods and Services Tax (SGST)? 23
8.3 What is Integrated Goods and Services Tax (IGST)? 23

1 Part 1: Basics of Budget

1.1 Introduction to Budget

A budget is an **estimation of receipts and expenses** over a specified future period of time and is utilized by **governments, businesses, and individuals**. Budgets can be made for a person, a group of people, a business, a government, or just about anything else that makes and spends money.

Government budget or Fiscal budget is a forecast by a government of its expenditures and revenues for a specific period of time. In national finance, the period covered by a budget is usually a year, known as a financial or fiscal year, which may or may not correspond with the calendar year. The word budget is derived from the **Old French bougette ("little bag").**

Concept Check
Q. Which among the following is not accounted as expenditure in a government budget?
(a) Transfer payment
(b) Subsidy
(c) Disinvestment proceeds
(d) Capital infusion into PSUs
(e) Debt service
Answer: C

KEY DEFINITION

Subsidy: A subsidy is a benefit given to an individual, business, or institution, usually by the government. It is usually in the form of a cash payment or a tax reduction. The subsidy is typically given to remove some type of burden, and it is often considered to be in the overall interest of the public, given to promote a social good or an economic policy.

Progressive Tax System: A progressive tax is one in which the proportion of income paid in taxes is greater for higher income levels. A progressive income tax exists, for example, if taxpayers with more income pay a 25% of their income in taxes, while those with less income pay 20%.

Union Budget of India – Key Facts

- According to **Article 112** of the Indian Constitution, the **Union Budget** of a year, referred to as the **annual financial statement** (AFS), is a statement of the **estimated receipts and expenditure** of the government for that particular year.
- The Union Budget keeps the account of the **government's finances for the financial year** that runs from **April 1 to March 31**.
- The Annual Financial Statement **distinguishes the expenditure on revenue account from the expenditure on other accounts**, as mandated by the Constitution of India.
- In the Budget, the **receipts and disbursements are shown in three parts** in which Government Accounts comprise (i) the **Consolidated Fund**, (ii) the **Contingency Fund** and (iii) the **Public Account.**
- **The Budget Division of the Department of Economic Affairs in the finance ministry is the nodal body responsible for producing the Budget.**

Concept Check

Q. With reference to taxation system, which of the following statements is correct?

(a) In progressive taxation system, rate of taxation decreases with increase in income.
(b) In proportionate taxation system, rate of taxation remains constant at all income levels.
(c) In regressive taxation system rate of taxation increases with increase in income.
(d) Regressive taxation system is the most suited for tackling high inequality in a society.
(e) None of the above

Answer: B

Concept Check

Q. Which of the following measures should be adopted by a government in order to control inflation?

(a) Decrease income tax
(b) Increase subsidy
(c) Increase salaries of government employees
(d) Increase wages under MNREGA
(e) None of the above

Answer: E

2 Part 2: Basics of Fiscal Policy

2.1 Meaning of Fiscal Policy

Fiscal means something that is **related to public money or taxes**. **Fiscal policy** is an estimate of **taxation and government spending** that impacts the economy. It was John Maynard Keynes, the first economist who developed a theory linking fiscal policy and economic performance.

Fiscal policy in India is the guiding force that helps the government decide **how much money it should spend** to support the economic activity, and **how much revenue it must earn** from the system, to keep the wheels of the economy running smoothly.

Concept Check
Q. Which of the following is considered to be a tool of a government's fiscal policy?
(a) Cash Reserve Ratio
(b) Statutory Liquidity Ratio
(c) Repo Rate
(d) Reverse Repo Rate
(e) Taxation
Answer: E

2.2 Types of Fiscal Policy

There are two types of fiscal policy:

- **Expansionary fiscal policy**: This policy is designed to **boost the economy**. It is mostly used in times of **high unemployment and recession** (a slowdown or a massive contraction in economic activities). It leads to the **government lowering taxes and spending more**, or one of the two. The aim is to **stimulate the economy** and ensure **consumers' purchasing power** does not weaken.
- **Contractionary fiscal policy**: As the term suggests, this policy is designed to **slow economic growth** in case of **high inflation.** The contractionary fiscal policy **raises taxes and cuts spending.**

Concept Check
Q. In the context of economic recession, which of the above actions can be considered a part of the "fiscal stimulus" package?
(a) Cutting the tax rates
(b) Increasing the government spending
(c) Increasing the subsidies
(d) All of the above
(e) None of the above
Answer: D

2.3 Tools of Fiscal Policy

There are **two key tools of the fiscal policy**:

- **Taxation**: Funds in the form of **direct and indirect taxes** help the government function. Taxes affect the consumer's income and changes in consumption lead to changes in real gross domestic product (GDP). Before we proceed ahead, let us understand the distinction between direct and indirect taxes:
  - **Direct Taxes:** A direct tax is **paid by an individual or organization to the entity that levied the tax**. Direct taxes include **income tax, property tax, corporate tax, estate tax, gift tax,** and taxes on assets.
  - **Indirect Taxes:** An indirect tax is **collected by one entity** in the supply chain (usually a **producer or retailer**) and **paid to the government**, but it is **passed on to the consumer** as part of the purchase price of a good or service. The **consumer is ultimately paying the tax** by paying more for the product. Best example of indirect tax in the present times is the **Goods and Services Tax**. We will be discussing this in detail towards the end of this chapter.
- **Government spending**: It includes welfare programmes, government salaries, subsidies, infrastructure, etc. Government spending has the power to raise or lower real GDP, hence it is included as a fiscal policy tool.

2.4 Similarities & Difference between Monetary Policy and Fiscal Policy

2.4.1 Similarities

Both monetary and fiscal policy are **macroeconomic tools** used to **manage or stimulate the economy**. The government uses both monetary and fiscal policy to **meet the county's economic objectives**. Both aim at creating a **more stable economy** characterized by **low inflation and positive economic growth**.

Both fiscal and monetary policy are an attempt to **reduce economic fluctuations** and smooth out the economic cycle.

2.4.2 Differences

Monetary policy is concerned with the **management of interest rates** and the total supply of money in circulation. It is generally carried out by the RBI.

Fiscal policy, on the other hand, estimates **taxation and government spending**. It should ideally be **in line with the monetary policy**, but since it is created by lawmakers, people's interest often takes precedence over growth.

Concept Check
Q. With reference to fiscal policy and monetary policy, which of the following options is correct?
(a) Monetary policy decisions are within the domain of the Reserve Bank of India.
(b) Taxation and expenditure are the main tools of monetary policy.
(c) Policy rate is the chief tool of fiscal policy.
(d) All of the above
(e) None of the above
Answer: A

3 Part 3: Components of Budget

Government Budget in India is divided into **two parts** – **Revenue Budget and Capital Budget**.

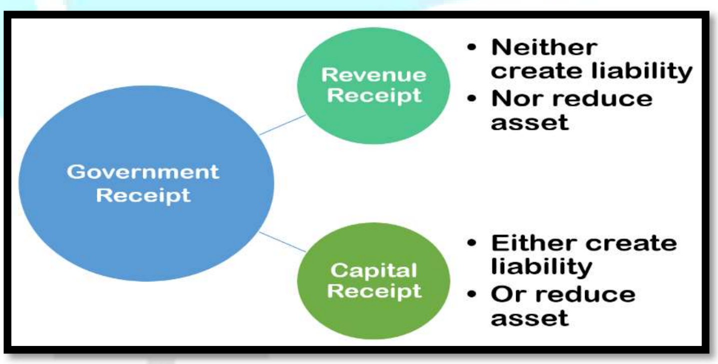
The **Revenue Budget** comprises **revenue receipts and expenditure** met from these revenues. The **revenue receipts** include both **tax revenue** (like income tax, excise duty) and **non-tax revenue** (like interest receipts, profits).

Capital Budget consists of **capital receipts** (like borrowing, disinvestment) and **long period capital expenditure** (creation of assets, investment).

We will be discussing each one of these components elaborately in the subsequent sections.

3.1 Receipts

Government receipts are divided into **two groups**—**Revenue Receipts** and **Capital Receipts**. All Government receipts which **either create liability or reduce assets** are treated as capital receipts whereas receipts which **neither create liability nor reduce assets** of Government are called **revenue receipts**. Before we move ahead, let us understand the distinction between assets and liabilities:



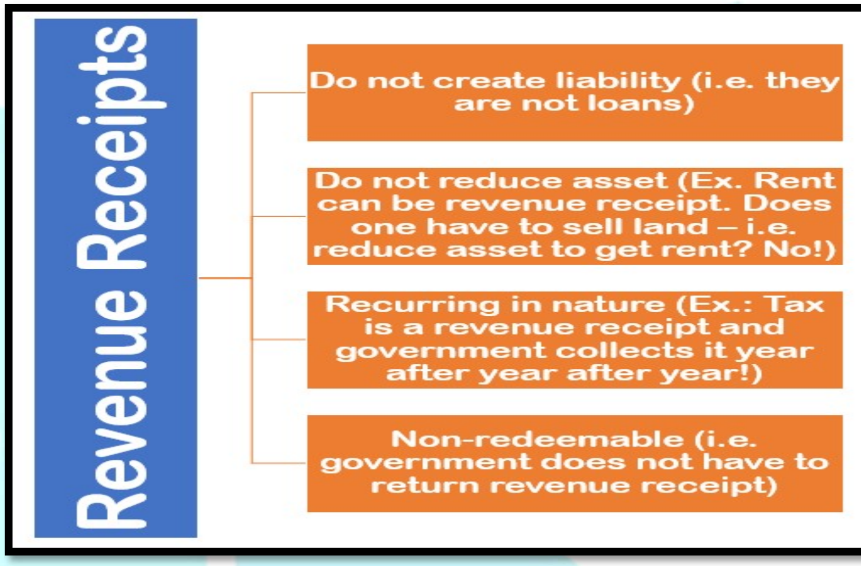
- **Asset**: **Something that you own**. For a person, assets can be financial, like **money, stocks, bonds,** bank accounts, and government securities, or they can be **physical things, like cars, boats, houses, clothes, food, and land.** The important assets for our economy are the output we have produced and the resources, **capital, and natural resources** used to produce that output. An important point to note about assets is that they can **lead to future streams of income**. Consider the following examples: **Land** is an **asset** that can lead to **future streams of income** in the form of **rent**. **Machine** is an **asset** that can help produce **goods**, which when sold can lead to **future streams of income** in the form of **profit**. Similarly, a sum of **money lent as loan** can be considered to be an **asset** as it can lead to **future**

streams of income in the form of **interest**. (So now you understand the meaning of non-performing assets! Simply put, NPAs are those loans on which the lending bank is not earning any interest.)

- **Liability**: **Something that you owe**. The biggest liabilities for most consumers are **loans**, including **mortgages**, **car loans, credit-card balances**, and installment accounts at stores. For a **government**, the **loans that it may have taken from domestic and external sources** constitute a major component of its liability. An important point to note about liabilities is that **they can lead to future streams of payout.** Easiest example of a liability is **borrowings**. Borrowings lead to a **future stream of payout in the form of interest.**

3.1.1 Revenue Receipts

Revenue Receipt: Receipts which are **recurring (received again and again)** by nature and which are available for meeting all **day-to-day expenses** (revenue expenditure) of a business concern are known as "Revenue receipts", e.g., **sale proceeds of goods, interest received, commission received, rent received, dividend received** etc. In case of government**, tax revenue** is a major component of revenue receipts.



Revenue receipts are those receipts that **do not lead to a claim on the government (i.e., government is not obligated to repay the money received as revenue receipt)**. They are therefore termed **non-redeemable**.

They are divided into **tax and non-tax revenues**.

3.1.1.1 Tax Revenues

Tax revenues, an important component of revenue receipts, have for long been divided into **direct taxes** (**personal income tax**) and firms (**corporation tax**), and **indirect taxes** like **excise taxes** (duties levied on goods produced within the country), **customs duties** (taxes imposed on goods imported into and exported out of India) and **service tax**.

Other **direct taxes** like **wealth tax, gift tax and estate duty** (now abolished) have never brought in large amount of revenue and thus have been referred to as '**paper taxes**.

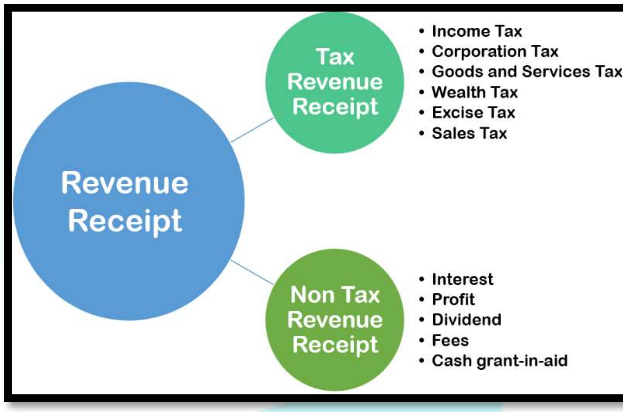
The **redistribution objective** is sought to be achieved through **progressive income taxation**, in which **higher the income, higher is the tax rate.**

Firms are taxed on a **proportional basis**, where the **tax rate is a particular proportion of profits.**

> **KEY DEFINITION**
> **Proportional Tax:** A tax in which people pay the same percentage of income in taxes regardless of their incomes. Here's an example of a proportional tax -- You earn Rs 10,000 a year and your boss get Rs 20,000. You pay Rs 1,000 in taxes (10 percent) and your boss pays Rs 2,000 in taxes (10 percent).

3.1.1.2 Non-Tax Revenue

Following are the examples of Non-Tax Revenue Receipts:



1. **Profits and dividends** (a sum of money paid regularly by a company to its shareholders out of its profits) which the government gets from its public sector undertakings (PSUs).
2. **Interests** received by the government out of all loans forwarded by it, be it inside the country (i.e., internal lending) or outside the country (i.e., external lending). It means this income might be in both domestic and foreign currencies.
3. **Fiscal services** also generate incomes for the government, i.e., printing currency, stamp printing, coinage and medals minting, etc.
4. **General Services** also earn money for the government as the power distribution, irrigation, banking, insurance, community services, etc.
5. **Fees, penalty and fines** received by the government.
6. **Cash grants-in-aid** (payments in the nature of assistance, donations or contributions made to one government by another government, body, institution or individual) from foreign countries and international organisations are also included. Grants is always external in the case of the Central Government and internal in the case of state governments.

Concept Check

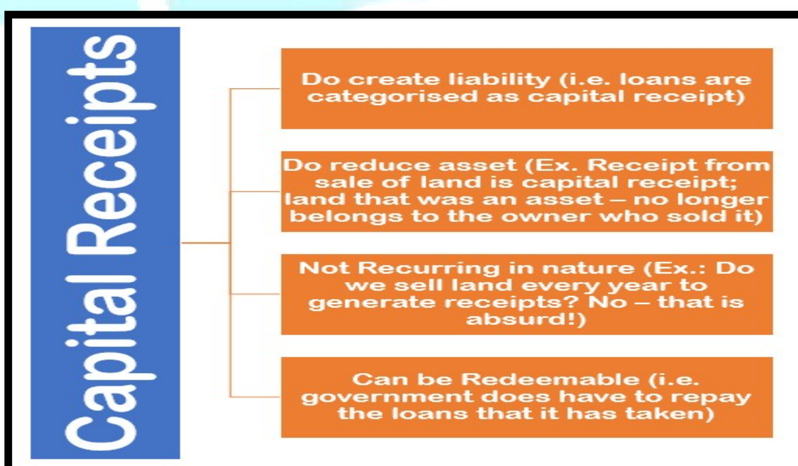
Q. Which of the following forms a part of the non-tax revenue receipts of the Government of India?

(a) Profits earned from Public Sector Undertakings (PSUs)
(b) Fines received by the government
(c) Grants
(d) All of the above
(e) None of the above

Answer: D

3.1.2 Capital Receipts

Receipts which are **non-recurring (not received again and again)** by nature and whose **benefit is enjoyed over a long period are called "Capital Receipts",** e.g., money brought into the business by the owner (capital invested), loan from bank, sale proceeds of fixed assets etc. Capital receipt is shown on the **liabilities side of the Balance Sheet**.



The capital receipts in India include the following capital kind of accruals to the government:

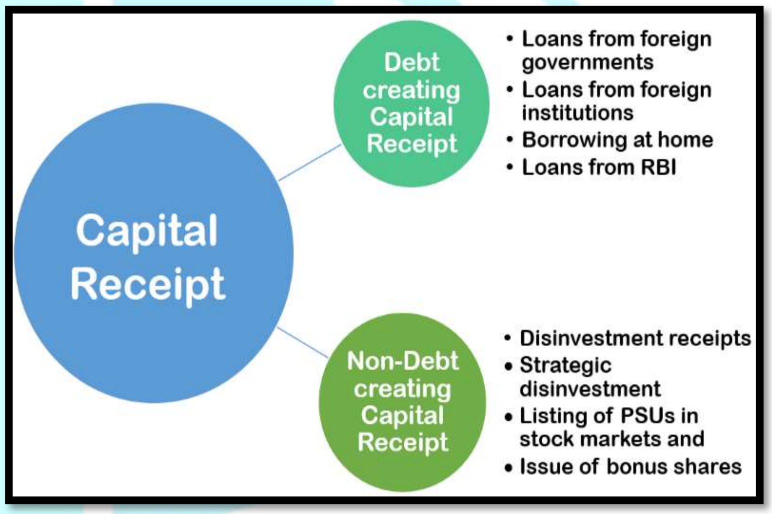
1. **Loan Recovery**: This is one **source of the capital receipts**. The money the government has lent out in the past in India (to states, UTs, PSUs, etc.) and abroad their capital comes back to the government when the borrowers repay them as capital receipts. The interests which come to the government on such loans are part of the revenue receipts.

2. **Borrowings by the Government**: This includes all **long-term loans raised by the government** inside the country (i.e., **internal borrowings**) and outside the country (i.e., **external borrowings**). Internal borrowings might include the borrowings from the RBI, Indian banks, financial institutions, etc. Similarly, external borrowings might include the loans from the World Bank, the IMF, foreign banks, foreign governments, foreign financial institutions, etc. **Loans will have to be returned** to the agencies from which they have been borrowed. Thus, they **create liability (liabilities are something that we owe to others. These have to be re-paid, usually with an interest)**.

3. **Other Receipts by the Government**: This includes many **long-term capital** accruals to the government through the **Provident Fund (PF), Postal Deposits**, various small saving schemes and the government bonds sold to the public (as **Indira Vikas Patra, Kisan Vikas Patra** etc.). Such receipts are nothing but a **kind of loan** on which the government needs to pay interests on their maturities. But they play a role in capital raising process by the government.
4. The government also receives money **sale of its assets**. **Sale of government assets**, like sale of shares in Public Sector Undertakings (PSUs) (Air India, BPCL, HPCL, IOCL and ONGC are some examples of PSUs in India – Government of India is the majority stakeholder in these companies) which is referred to as PSU ***disinvestment***, **reduce the total amount of financial assets** of the government.

3.1.3 Distinction between Debt Creating Capital Receipts and Non-Debt Creating Capital Receipts

When **government takes fresh loans,** it will mean that in future these loans **will have to be returned** and **interest** will have to be **paid** on these loans. Similarly, when **government sells an asset**, then it means that in **future** its **earnings** from that **asset**, will **disappear**. Thus, these receipts can be **debt creating or non-debt creating**.



Loan is a **debt creating capital receipts.** Loan has to be **repaid with interest**. It is a **debt obligation**. On the other hand, **money received** by the government through **sale of stake (disinvestment)** in a public sector enterprise is a **non-debt creating capital receipt**. Government **does not have to repay this money back** to anyone. It is **not a debt obligation.**

Note that **non debt capital receipts of the union government** include:

- **Recoveries of loans and advances** given to state governments, Union territories and foreign governments. (In simpler terms, this means that Government is taking back the money it had given out as a loan to a borrower)
- Money accrued to the Union government from **listing** (listing refers to a company's shares being included on the list of stock that are officially traded on a stock exchange) of central government companies. Consider the following example to understand this point better: Indian Railway Catering and Tourism Corporation (IRCTC) was listed on the National Stock Exchange and the Bombay Stock Exchange by the Government of India on October 14, 2019. Through selling its shares, the government offloaded 12.6% stake in IRCTC and garnered around Rs 645 crore.

The government further classifies disinvestment proceeds into: Disinvestment receipts, Strategic disinvestment, Listing of PSUs in stock markets and, Issue of bonus shares

Over a period, disinvestment has become the main source of the Union government's non debt capital receipts.

KEY DEFINITION
Disinvestment: Disinvestment means sale or liquidation of assets by the government, usually Central and state public sector enterprises, projects, or other fixed assets. The government undertakes disinvestment to reduce the fiscal burden on the exchequer, or to raise money for meeting specific needs, such as to bridge the revenue shortfall from other regular sources. In some cases, disinvestment may be done to privatise assets. However, not all disinvestment is privatisation.

3.1.4 Distinction between Revenue Receipt and Capital Receipt

Effect

- **Revenue Receipt:** It has **short-term** effect. The benefit is enjoyed within **one accounting period**.
- **Capital Receipt:** It has **long-term** effect. The benefit is enjoyed for **many years in future**.

Occurrence

- **Revenue Receipt:** It occurs **repeatedly**. It is **recurring** and **regular**.
- **Capital Receipt:** It does not occur again and again. It is **non-recurring** and **irregular**.

Assets/Liabilities

- **Revenue Receipt:** This **does not increase or decrease** the value of **asset** or **liability**.
- **Capital Receipt:** The capital receipt **decreases** the value of **asset** or **increases** the value of **liability** e.g., sale of a fixed asset, loan from bank etc.

Concept Check
Q. Which of the following option consists of items that can all be classified as revenue receipt?
(a) Income Tax, Corporation Tax, Wealth Tax and Disinvestment receipts
(b) Borrowing at home, Loans from RBI, Sales Tax and Fines
(c) Profit, Corporation Tax, Goods and Services Tax and Borrowing at home
(d) Interest, Dividend, Income Tax and Fees
(e) None of the above
Answer: D

3.2 Expenditure

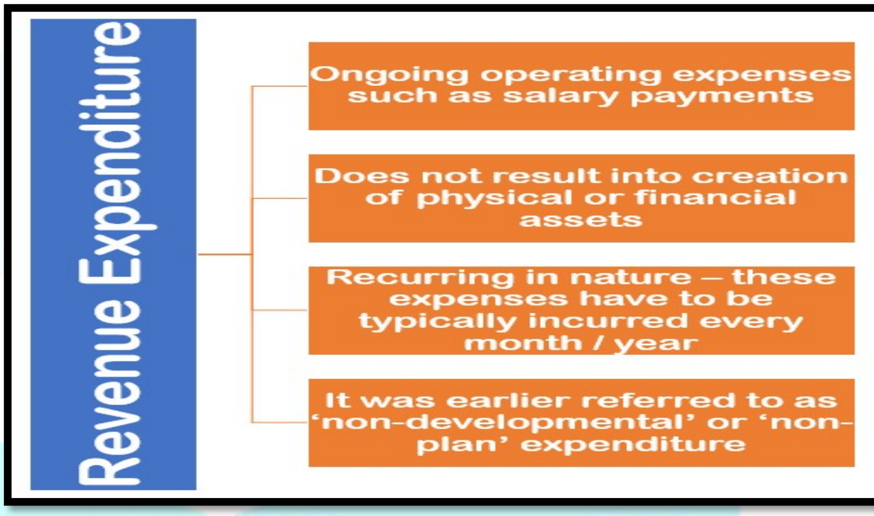
Expenditure can be classified under **two heads – revenue expenditure and capital expenditure**. The differences between capital expenditures and revenue expenditures include whether the purchases will be used over the long-term or short-term.

Revenue expenditures are typically referred to as **ongoing operating expenses (it is an ongoing cost for running a product, business, or system)**.

Capital expenditures are typically **one-time large purchases of fixed assets** that will be used for **revenue generation** over a longer period.

Concept Check
Q. Which of the following is not an example of developmental expenditure?
(a) Grants to states
(b) Developing infrastructure projects
(c) Defence expenditure
(d) Developing railways
(e) None of the above
Answer: C

3.2.1 Revenue Expenditure



Revenue Expenditure is expenditure incurred for **purposes other than the 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 (even though some of the grants may be meant for creation of assets).

The main items of revenue expenditure are **interest payments, defence services, subsidies, salaries and pensions.** Some of this expenditure is also referred to as 'charged expenditure'.

Interest payments on market loans, external loans and from various reserve funds constitute one of the largest components of revenue expenditure.

Defence expenditure, is committed expenditure in the sense that given the national security concerns, there exists little scope for drastic reduction. (Committed expenditure is the expenditure of the governments from which they cannot deny, i.e., a government has to undertake this expenditure and there is very less scope for reducing it.)

Subsidies are an important policy instrument which aim at increasing welfare. Apart from providing **implicit subsidies** through **under-pricing of public goods and services** like education and health, the government also extends **subsidies explicitly** on items such as **exports, interest on loans, food and fertilisers.**

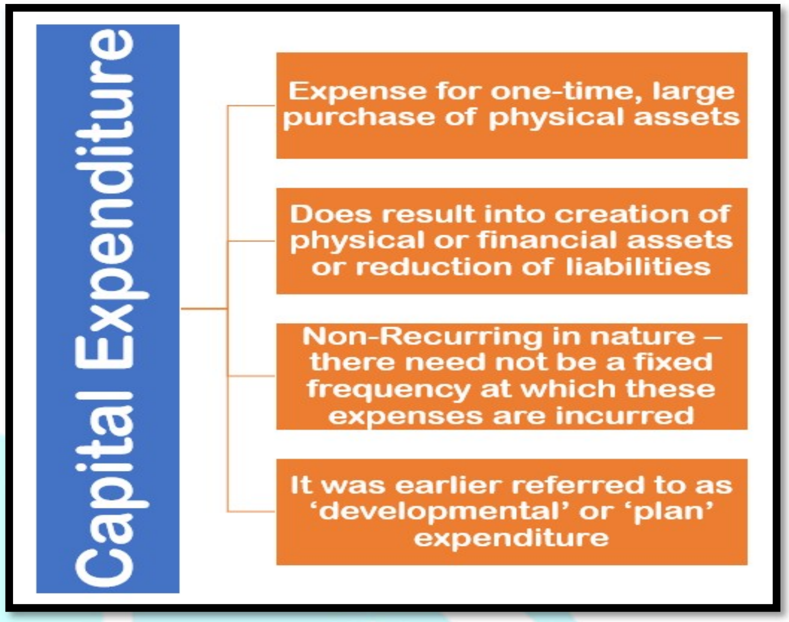
Concept Check
Q. Which of the items given below forms a part of 'Revenue Expenditure'?
(a) Salaries, Pension and Provident Fund paid by the government
(b) Grants given by the government to Indian States and foreign countries
(c) Subsidies forwarded to all sectors
(d) Law and order expenditure
(e) All of the above
Answer: E

3.2.2 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, equipment, investment in shares, and loans and advances by the central government** to state and union territory governments, PSUs and other parties.

Capital expenditure is the part of the government spending that goes into the creation of assets like **schools, colleges, hospitals, roads, bridges, dams, railway lines, airports and seaports**. Capital expenditure also covers the acquisition of **equipment and machinery** by the government, including those for **defence purposes**. Capital expenditure also includes **investment** by the government that **yields profits or dividend in future**.



Examples of Capital Expenditure are as follows:

1. **Loan Disbursals by the Government:** The loans forwarded by the government might be internal (i.e., to the states, UTs, PSUs) or external (i.e., to foreign countries, foreign banks, purchase of foreign bonds, loans to IMF and WB, etc.)
2. **Loan Repayments by the Government:** Again, loan payments might be internal as well as external. This consists of only the capital part of the loan repayment as the element of interest on loans are shown as a part of the revenue expenditure.
3. **Plan Expenditure of the Government:** This consists of all the expenditures incurred by the government to finance the planned development of India as well as the central government financial supports to the states for their plan requirements.
4. **Capital Expenditures on Defence by the Government:** This consists of all kinds of capital expenses to maintain the defence forces, the equipment purchased for them as well as the modernisation expenditures.
5. **General Services:** These also need huge capital expenditure by the government - the **railways, postal department, water supply, education, rural extension, etc.**

Concept Check
Q. Which among the following is not one of the features of capital expenditure?
(a) It is non-recurring in nature.
(b) It leads to creation of either physical asset or financial asset.
(c) It can also refer to as developmental expenditure.
(d) It can result in an increase in the productive capacities of an economy.
(e) None of the above
Answer: E

3.2.3 Difference between Revenue Expenditure and Capital Expenditure

	Revenue Expenditure		Capital Expenditure
1.	Its effect is **temporary**, i.e., the benefit is received within the accounting year.	1.	Its effect is **long-term**, i.e., it is not exhausted within the current accounting year-its benefit is received for a number of years in future.
2.	**Neither an asset is acquired** nor the value of an asset is increased.	2.	An **asset is acquired** or the value of an existing asset is increased.

3.	It has **no physical existence** because it is incurred on items which are used by the business.	3.	Generally, it has **physical existence** except **intangible assets**.
4.	It is **recurring and regular** and it occurs repeatedly.	4.	It **does not occur again and again**. It is nonrecurring and irregular.
5.	This expenditure helps to **maintain the business.**	5.	This expenditure **improves the position of the business.**
6.	It **does not appear in the balance sheet.**	6.	It **appears in the balance sheet** until its benefit is fully exhausted.
7.	It **reduces profit** of the business.	7.	It **does not reduce the profit** of the concern. Purchase of fixed asset does not affect profit.

RELATED CONCEPTS
Developmental and Non-Developmental Expenditure
Total expenditure incurred by the government is classified into two segments - developmental and non-developmental.
All **expenditures of productive nature are developmental** such as on the heads of new **factories, dams, bridges, roads, investments.**
The **expenditure which are of consumptive kind** and do not involve any production are **non-developmental**, i.e., **paying salaries, pensions, interest payments, subsidies, defence expenses, etc.**
This classification is not used in the Indian public finance management now.

Concept Check
Q. Which among the following is not one of the features of revenue expenditure?
(a) It is also referred to as consumptive expenditure.
(b) It helps in the day-to-day functioning of an organization.
(c) It can often be in the form of committed expenditure.
(d) It was earlier referred to as non-plan expenditure.
(e) None of the above
Answer: E

4 Part 4: Balanced, Surplus & Deficit Budget

4.1 Balanced Budget

A government budget is said to be a balanced budget if the **estimated government expenditure is equal to expected government receipts** in a particular financial year.

This type of budget is based on the principle of **“living within means.”** It is believed the government’s **expenditure should not exceed their revenue.**

Though an ideal approach to achieve a balanced economy and maintain fiscal discipline, a balanced budget **does not ensure financial stability at times of economic *depression* or deflation**. Theoretically, it’s easy to balance the estimated expenditure and anticipated revenues but when it comes to practical implementation, such balance is hard to achieve.

4.2 Surplus Budget

A government budget is said to be a surplus budget if the **expected government revenues exceed the estimated government expenditure** in a particular financial year. A **surplus budget** denotes the **financial**

affluence of a country. Such a budget can be **implemented at times of inflation to reduce aggregate demand.**

Putting it in simpler terms, during times of **inflation**, it is important to **keep aggregate demand under control**. **Government can help** in keeping the aggregate demand under control by **reducing its own expenditure**. This is precisely what is achieved by running a **surplus budget** wherein the **expenditure is kept below the revenue**.

4.3 Deficit Budget

A government budget is said to be a deficit budget if the **estimated government expenditure exceeds the expected government revenue** in a particular financial year. This type of budget is **best suited for developing economies**, such as India. Especially **helpful at times of recession**, a deficit budget helps **generate additional demand** and **boost the rate of economic growth**. Here, the government incurs the excessive expenditure to **improve the employment rate**. This results in an **increase in demand** for goods and services which helps in **reviving the economy**. The government covers this amount through **public borrowings** (by issuing government bonds) or by withdrawing from its accumulated reserve surplus.

5 Part 5: Types of Budgets in India

5.1 Zero-Base Budgeting

The idea of zero-base budgeting (ZBB) first came to the privately owned organization of the USA by the 1960s. It was the US financial expert Peter Phyrr who first proposed this idea for government budgeting and Jimmy Carter, Governor of Georgia, USA was the first elected executive to introduce ZBB to the public sector. When he presented the **US Budget in 1979** as the US President it was the first use of the ZBB for any nation state. Since then, many governments of the world have gone for such budgeting.

ZBB is the **allocation of resources** to agencies based on **periodic re-evaluation** by those agencies of the **need for all the programmes** for which they are responsible, **justifying the continuance or termination of each programme** in the agency budget proposal - in other words, an **agency reassess** what it is doing from top to bottom from a **hypothetical zero base.**

There are **three essential questions** which must be **answered objectively** before going for any expenditure as per the techniques of ZBB:

1. **Should we spend?**
2. **How much should we spend?**
3. **Where should we spend?**

In India, it is believed to be in practice since 1997-99. We cannot say that India is a success in ZBB, but many of the profit-fetching PSUs have been able to use it successfully and optimize their profits.

5.2 Gender Budgeting

A gender budget by the government which **allocates funds and responsibilities on the basis of gender** is gender budgeting. It is done in an economy where **socio-economic disparities are chronic and clearly visible on a sex basis.**

Gender budgeting started in India with the Union Budget of 2006-07 which proposed an outlay of Rs 28,737 crore dedicated to the cause of women and created gender budgeting cells in 32 ministries and departments.

5.2.1 What is Gender Budgeting?

- GB is concerned with **gender sensitive formulation of legislation, programmes and schemes**; **allocation of resources**; **implementation and execution; audit and impact assessment** of programmes and schemes; and **follow-up corrective action** to address gender disparities.
- A powerful tool for achieving **gender mainstreaming** so as to ensure that benefits of development reach women as much as men.
- **Does not seek to create a separate budget** but seeks affirmative action to **address specific needs of women.**
- Monitors **expenditure** and **public service delivery** from a **gender perspective**.
- Entails dissection of the Government budgets to establish its gender differential impacts and to ensure that **gender commitments** are translated in to **budgetary commitments**.

5.3 Outcome and Performance Budgets

The concepts are part of **result-oriented budgeting**. Both go for **'quantitative' as well as 'qualitative' progress reports** of the performance of the government.

While **outcome budget** is presented by **different departments and divisions** of a ministry or the government, the **performance budget** is presented by the **ministry of finance** on behalf of the government.

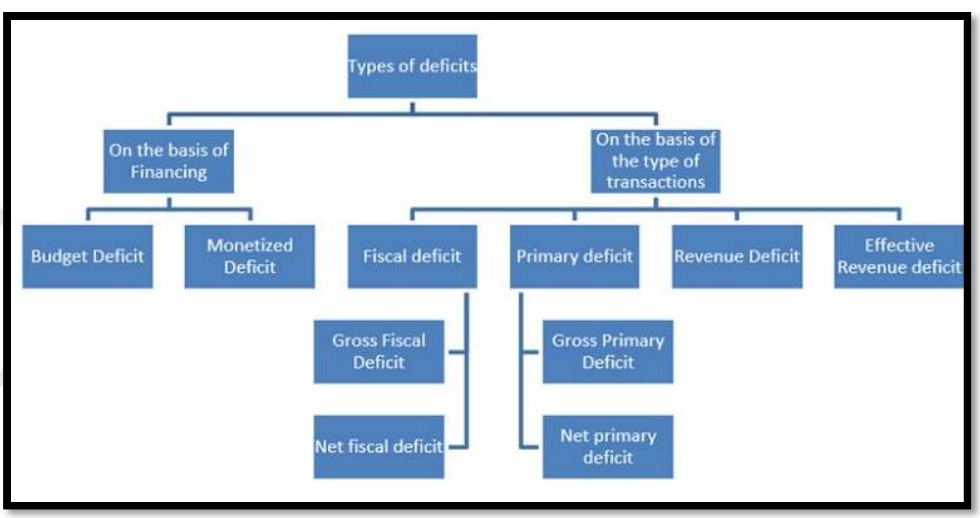
The **outcome budget** is a **micro level** process while **performance budget** is a **macro level** process in budgeting. There are **many outcome budgets in any one performance budget.**

The basic objective of such budgeting is to **bring in transparency** and thereby making the **government** more and **more responsible** to the house and the public. Naturally, they bring in **prudence** and **optimisation elements** in public spending.

Concept Check
Q. 'Output Outcome Framework' has been developed by…
(a) Ministry of Statistics and Programme Implementation
(b) Department for Promotion of Industry and Internal Trade
(c) National Informatics Centre
(d) Development Monitoring and Evaluation Office (NITI Aayog)
(e) Reserve Bank of India
Answer: D

6 Part 6: Measures of Government Deficit

The broad measures of deficit (which have been and/or are being) reported by the government in India, may be classified, either in terms of the **'nature of transactions'** or on the basis of the **'means of financing'** them.



6.1 Revenue Deficit

Revenue deficit is a fiscal terminology used since the fiscal 1997-98 in India. The revenue deficit refers to the **excess of government's revenue expenditure over revenue receipts.**

The formula for Revenue deficit is:

Revenue deficit = Revenue expenditure – Revenue receipts

The revenue deficit includes only such transactions that affect the **current income and expenditure** of the government.

When the government incurs a **revenue deficit**, it implies that the **government is dissaving** and is using up the savings of the other sectors of the economy to finance a part of its consumption expenditure. This situation means that the government will have to **borrow not only to finance its investment but also its consumption requirements**. This will lead to a **build-up of stock of debt and interest liabilities** and force the government, eventually, to cut expenditure.

6.2 Effective Revenue Deficit

Effective Revenue deficit is a new term **introduced in the Union Budget 2011-12.**

While **revenue deficit** is the difference between revenue receipts and revenue expenditure, the **present accounting system includes all grants from the Union** Government to the state governments/Union territories/other bodies as revenue expenditure, **even if they are used to create assets.**

Such assets created by the sub-national governments/bodies are owned by them and not by the Union Government. Nevertheless, they do result in the creation of **durable assets**.

According to the Finance Ministry, **such revenue expenditures contribute to the growth** in the economy and therefore, should **not be treated as unproductive in nature.**

In the Union Budget (2011-12) a new methodology has been introduced to capture the **'effective revenue deficit'**, which **excludes** those **revenue expenditures (or transfers) in the form of Grants for Creation of Capital Assets (GoCA).**

Grants for creation of capital assets, as a concept, was introduced in the **Fiscal Responsibility & Budget Management Act 2003 through the amendment in 2012.** The Act defines grants for creation of capital assets as **grants-in-aid given by the Central Government** to state governments, autonomous bodies, local bodies and other scheme implementing agencies for **creation of capital assets** which are owned by these entities. (We will be reading about this act in detail in a forthcoming section)

In short, **Effective Revenue Deficit** is the **difference** between **revenue deficit and grants for creation of capital assets.**

Effective Revenue Deficit signifies that **amount of capital receipts** that are being **used for actual consumption expenditure of the Government**.

6.3 Gross Fiscal Deficit

Gross Fiscal deficit is the **difference between the government's total expenditure and its total receipts excluding borrowing.**

Total Receipts = Revenue Receipts + Capital Receipts

The above formula can also be written as:

Total Receipts = Revenue Receipts + Non-debt creating capital receipts + Debt-creating capital receipts

Borrowing is nothing but Debt-creating capital receipt

<u>The formula for Gross fiscal deficit is:</u>

Gross Fiscal Deficit = Total Expenditure – (Total Receipts excluding borrowing)

Gross fiscal deficit = Total expenditure – (Revenue receipts + Non-debt creating capital receipts)
OR
Gross fiscal deficit = Total expenditure of the government (capital and revenue expenditure) – Total income of the government (Revenue receipts + recovery of loans + other receipts)
Non-debt creating capital receipts are those **receipts which are not borrowings** and, therefore, **do not give rise to debt**. Examples are **recovery of loans** and the **proceeds from the sale of PSUs.**

The gross fiscal deficit will have to be **financed through borrowing**. Thus, it **indicates** the **total borrowing requirements** of the government from all sources.

<u>From the financing side, the formula for Gross fiscal deficit is:</u>

Gross fiscal deficit = Net borrowing at home + Borrowing from RBI + Borrowing from abroad

Net borrowing at home includes that directly **borrowed from the public** through debt instruments (for example, the various small savings schemes) and indirectly from **commercial banks** through **Statutory Liquidity Ratio (SLR).**

The **gross fiscal deficit** is a key variable in judging the **financial health** of the public sector and the **stability** of the economy.

From the way gross fiscal deficit is measured as given above, it can be seen that **revenue deficit is a part of fiscal deficit.**

<u>The formula showing relation between Gross Fiscal deficit and Revenue deficit is:</u>

Gross Fiscal Deficit = Revenue Deficit + Capital Expenditure – non-debt creating capital receipts

A **large share of revenue deficit in fiscal deficit** indicated that a large part of **borrowing** is being **used to meet its consumption expenditure** needs rather than investment.

Concept Check:
Q. Term 'fiscal deficit' is best defined by which of the following options?
(a) Excess of Total Expenditure over Total Receipts
(b) Excess of Revenue Expenditure over Revenue Receipts
(c) Excess of Total Expenditure over Total Receipts less borrowings
(d) Excess of Total Expenditure over Total Receipts less borrowings and Interest Payments
(e) None of the above
Answer: C

6.4 Net Fiscal Deficit

Fiscal deficit can be either **'gross' or 'net'**.

The **Central government** makes **capital disbursements as loans** to the different segments of the economy. In the developing countries, a large part goes as loans to other sectors – **States and local Governments, public sector enterprises** and the like.

Net fiscal deficit can be arrived at by deducting net domestic lending from gross fiscal deficit.

6.5 Gross Primary Deficit
We must note that the **borrowing requirement** of the government **includes interest obligations** on **accumulated debt**.

The goal of measuring **gross primary deficit** is to focus on **present fiscal imbalances**.

To obtain an estimate of borrowing on account of **current expenditures exceeding revenues**, we need to calculate what has been called the **primary deficit**. It is simply the **fiscal deficit minus the interest payments.**

<u>The formula for Gross primary deficit is:</u>

Gross primary deficit = Gross fiscal deficit – Net interest liabilities

Net interest liabilities consist of **interest payments minus interest receipts** by the government on net domestic lending.

6.6 Net Primary Deficit
Net primary deficit is gross primary deficit minus net domestic lending.

6.7 Traditional Budget Deficit
It is **that part of the government's deficit** which is **financed through short-term borrowings**. These short-term borrowings may be **from the RBI or from other sources.**

Normally, short-term borrowings from the RBI are through the net issuance of **short-term treasury bills** (that is, ad-hoc and ordinary treasury bills) and by **running-down the central government's cash balances** held by the RBI.

6.8 Monetized Deficit
Monetized deficit, also known as the **'net reserve bank credit to the government'**, is that part of the government deficit which is **financed solely by borrowing from the RBI.**

Since **borrowings** from the RBI can be **both short-term and long-term**, therefore, monetized deficit is the **sum of** the net issuance of **short-term treasury bills, dated securities** (that is, long-term borrowing from the RBI) and **rupee coins** held exclusively by the RBI, **net of Government's deposits with the RBI.**

This is different from the Traditional Budget deficit in two ways:

1. **Traditional Budget deficit** includes **91-day treasury bills held by both, the RBI and non-RBI entities** whereas **Monetized deficit** includes **91-day Treasury Bills held only by the RBI.**
2. **Traditional Budget deficit** includes **only short-term sources** of finance whereas **Monetized deficit** includes **long-term securities also.**

6.9 Significance of Different Measures of Deficit

6.9.1 Fiscal Deficit
- Widely used as a **summary indicator** of the **macroeconomic impact of the budget** in several industrialized countries.
- This measure has been **adopted by the International Monetary Fund (IMF)** as the **principal policy target** in their programmes. In **India**, the government began to report the fiscal deficit **only after 1991**.
- Since the shortfall in receipts over expenditure must be covered through borrowing, therefore, Gross Fiscal Deficit, gives the **overall borrowing requirements** of the government **over a given financial year**.
- And it thus shows the **net addition to the level of public debt** during a financial year.

6.9.2 Budget Deficit

- In the presence of the system of **automatic monetization of deficits** through issuance of **ad-hoc treasury bills**, this measure of deficit, becomes an **important target** to keep in check.
- However, in the **year 1997**, the **government discontinued** the issuance of **ad-hoc and tap treasury bills.**
- As a result of this, now, the **concept of budget deficit** in the **traditional sense** has **lost its significance** in public finance and is now not reported in the Budget documents of the Government of India.

6.9.3 Monetized Deficits

- **Monetization** of deficits, which **increases the money supply**, is **inflationary** if the rate of **growth of money supply is greater than the rate of increase of the demand for cash balances** arising from the growth of the economy.
- Thus, monetized deficits are an important indicator of the inflationary impact of the increase in government's budgetary deficits.

6.9.4 Primary Deficits

- It **excludes the burden of the past debt** and shows the net increase in the government's indebtedness due to the **current year's fiscal operations.**
- A **reduction in primary deficit** is reflective of **government's efforts at bridging the fiscal gap** during a financial year.

6.9.5 Revenue Deficit

- A **positive revenue deficit** implies that the government is resorting to **borrowing to finance current consumption.**

6.10 Deficit Financing

The **act/process of financing/supporting a deficit budget** by a government is deficit financing. In this process, the government knows well in advance that its **total expenditures are going to turn out to be more than its total receipts** and enacts/follows such financial policies so that it can sustain the burden of the deficits proposed by it.

Means of Deficit Financing are as follows:

1. **External Aids** are the best money as a means to fulfil a government's deficit requirements even if it is a **soft loan** (A soft loan is a loan with a below-market rate of interest). If they are coming without interest nothing could be better.
2. **External Grants** are even better elements in this case as they come free - **neither interest nor any repayments.**
3. **External Borrowings** are the next best way to manage fiscal deficit with the condition that the **external loans are comparatively cheaper and longer term**.
4. **Internal Borrowings** come as the **next preferred route** of fiscal deficit management. But going for it in a huge way **can hamper the consumption and investment prospect of the public and the corporate sector** as these sectors have **less access to domestic funds** since government has already borrowed a huge chunk of it. External borrowing may be preferred over internal borrowings due to 'crowding out effect'. If the government itself goes on borrowing from the banks in the country, from where will others borrow for investment purposes?

KEY DEFINITION
Crowding out effect: The crowding out effect is an economic theory arguing that rising public sector spending drives down or even eliminates private sector spending. The government spending is "crowding out" investment because it is demanding more loanable funds and thus causing increased interest rates and therefore reducing investment spending.

5. **Printing Currency**: This is the **last resort** for the government in managing its deficit. But it has a damaging effect on the economy: (a) It **increases inflation proportionally**. (India regularly went for it since the early 1970s and usually has to bear double digit inflations.) (b) It brings in regular **pressure and obligation on the government for upward revision in wages and salaries of government employees** - ultimately increasing the government expenditures necessitating further printing of currency and further inflation - a vicious cycle into which economies entangle themselves.

7 Part 7: Public Debt in India

7.1 Borrowings by the Centre and the States – Constitutional Provisions

Article 292 of Constitution of India "Borrowing by the Government of India": The **executive power of the Union** extends to **borrowing upon the security of the Consolidated Fund of India within such limits**, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed.

(Note: Government of India can borrow both internally as well as externally.)

The Union government describes those of its liabilities as **public debt**, which are **contracted against the Consolidated Fund of India**. This is as per **Article 292** of the Constitution.

The Union government includes **all other funds received outside Consolidated Fund of India** under **Article 266 (2) of the Constitution**, where the government merely acts as a **banker or custodian**. The second type of liabilities is called **public account.**

Article 293 of Constitution of India "Borrowing by States"

1. Subject to the provisions of this article, the executive power of a State extends to **borrowing within the territory of India** upon the **security of the Consolidated Fund of the State within such limits**, if any, as may from time to time be **fixed by the Legislature of such State** by law and to the **giving of guarantees within such limits**, if any, as may be so fixed.

(Note: State Governments can borrow only internally.)

2. The **Government of India may**, subject to such conditions as may be laid down by or under any law made by Parliament, **make loans to any State** or, so long as any **limits fixed under Article292 are not exceeded**, **give guarantees** in respect of loans raised by any State, and **any sums required for the purpose** of making such loans shall be **charged on the Consolidated Fund of India.**
3. A State may not without the **consent of the Government of India** raise any loan if there is still **outstanding** any part of a **loan** which has been **made to the State** by the Government of India or by its predecessor Government, or in respect of which a **guarantee has been given by the Government of India** or by its predecessor Government.
4. A consent under clause (3) may be granted subject to such conditions, if any, as the Government of India may think fit to impose.

Therefore, in India, **total Central Government Liabilities** constitutes the following **three categories**:

- **Internal Debt**
- **External Debt**
- **Public Account Liabilities**

7.2 Internal Debt

The major instruments covered under Internal Debt are as follows:

- **Dated Securities:** Primarily **fixed coupon securities** of **short, medium- and long-term** maturity which have a **specified redemption date.**
- **Treasury-Bills: Zero coupon securities** that are issued at a discount and redeemed in face value at maturity. These are issued to **address short term receipt-expenditure mismatches** under the auction program of the Government. These are primarily issued in **three tenors, 91,182 and 364 day.**
- **14 Day Treasury Bills**.
- **Securities issued to International Financial Institutions:** Securities issued to institutions viz. IMF, IBRD, IDA, ADB, IFAD etc. for India's contributions to these institutions etc.
- **Securities issued against 'Small Savings':** All deposits under small savings schemes are credited to the National Small Savings Fund (NSSF). The balance in the NSSF (net of withdrawals) is invested in special Government securities.
- **Market Stabilization Scheme (MSS) Bonds:** Governed by a MoU between the GoI and the RBI, **MSS was created to assist the RBI in managing its sterilization operations**. GoI borrows under this scheme from the RBI, while proceeds from such borrowings are maintained in a separate cash account with the latter and is used only for redemption of T-bills /dated securities raised under this scheme.
  Internal loans that make up for the bulk of public debt are further **divided into two broad categories – marketable and non-marketable debt.**

  - **Marketable Debt:** Dated government securities **(G-Secs)** and treasury bills **(T-bills)** are issued through auctions and fall in the category of marketable debt.
  - **Non-marketable Debt: Intermediate treasury bills** (with a maturity period of 14 days) issued to state governments and public sector banks, **special securities issued to National Small Savings Fund (NSSF)** are classified as non-marketable debt.

7.3 External Debt

Over the years, the Union government has followed a considered strategy to **reduce its dependence on foreign loans** in its overall loan mix. **Internal debt constitutes more than 93% of the overall public debt.**

Also, note that **external loans are not market loans.** They have been **raised from institutional creditors at concessional rates.** Most of these external loans are **fixed-rate loans, free from interest rate or currency volatility.**

Most of India's external debt was owed by private businesses which borrowed at attractive rates from foreign lenders.

While external debt may be denominated in either the rupee or a foreign currency like the U.S. dollar, **most of India's external debt is linked to the dollar.** This means Indian borrowers will have to pay back their lenders by first converting their rupees into dollars.

Concept Check
Q. Which of the following actions can be taken by the government to reduce the deficit?
(a) Reducing revenue expenditure
(b) Introducing new welfare schemes
(c) Rationalizing subsidies
(d) Raising taxes
(e) All except (b)
Answer: E

7.4 Fiscal Responsibility & Budget Management Act 2003

In a **multi-party parliamentary system, electoral concerns** play an important role in determining **expenditure policies**. A **legislative provision**, it is argued, that is **applicable to all governments** – present and future – is likely to be effective in **keeping deficits under control**.

The **enactment of the FRBMA, in August 2003,** marked a turning point in fiscal reforms, binding the government through an **institutional framework to pursue a prudent fiscal policy.**

The FRBM Act aims to introduce transparency in India's fiscal management systems. The Act's long-term objective is for India to **achieve fiscal stability** and to **give the Reserve Bank of India (RBI) flexibility to deal with inflation in India** (by committing the government to follow a path of fiscal prudence – i.e. government will not irrationally increase its own spending causing an upward pressure on inflation. The FRBM Act was enacted to introduce more equitable distribution of India's debt over the years.

The FRBM Act made it mandatory for the government to place the following along with the Union Budget documents in Parliament annually:

1. **Medium Term Fiscal Policy Statement**
2. **Macroeconomic Framework Statement**
3. **Fiscal Policy Strategy Statement**

The FRBM Act proposed that **revenue deficit, fiscal deficit, tax revenue and the total outstanding liabilities** be projected as a **percentage of gross domestic product** (GDP) in the medium-term fiscal policy statement. The objective of this act to put Indian on the fiscal path of elimination of revenue deficit and reining in of fiscal deficit.

Concept Check:
Q. Fiscal Responsibility and Budget Management Act (FRBMA) concerns:
(a) Revenue Deficit
(b) Total outstanding Debt as percentage of GDP
(c) Fiscal Deficit
(d) Tax to GDP ratio
(e) All of the above
Answer: E

8 Part 8: GST: One Nation, One Tax, One Market (Linked to Tax Revenue)

Goods and Services Tax (GST) is the **single comprehensive indirect tax**, operational from **1 July 2017**, on supply of goods and services, right from the manufacturer/ service provider to the consumer.

It is a **destination-based consumption tax** with facility of **Input Tax Credit** in the supply chain. It is applicable **throughout the country** with **one rate for one type of goods/service.** It has amalgamated a large number of Central and State taxes and cesses. It has **replaced large number of taxes on goods and services** levied on production/sale of goods or provision of service.

As there have been a number of intermediate goods/services, which were manufactured/provided in the economy, the **pre-GST tax regime-imposed taxes not on the value added at each stage but on the total value of the commodity/service** with **minimal facility of utilization of Input Tax Credit (ITC).** The total value included taxes paid on intermediate goods/services. This amounted to **cascading of tax.**

Under GST, the tax is discharged at every stage of supply and the **credit of tax paid at the previous stage is available for set off at the next stage of supply of goods and/or services**. It is thus effectively a **tax on value addition at each stage of supply.**

In view of our large and fast-growing economy, it addresses to establish **parity in taxation across the country**, and extend principles **of 'value- added taxation' to all goods and services.**

It has replaced various types of taxes/cesses, levied by the Central and State/UT Governments. Some of the major taxes that were levied by Centre were **Central Excise Duty, Service Tax, Central Sales Tax, and**

Cesses. The major State taxes were **VAT/Sales Tax, Entry Tax, Luxury Tax, Octroi, Entertainment Tax, Taxes on Advertisements, Taxes on Lottery /Betting/ Gambling, State Cesses** on goods etc. These have been subsumed in GST.

GST is categorized into **CGST, SGST or IGST** depending on whether the transaction is **Intra-State or Inter-State.**

To **determine whether Central Goods & Services Tax (CGST), State Goods & Services Tax (SGST) or Integrated Goods & Services Tax (IGST) will be applicable** in a taxable transaction, it is important to first know if the **transaction is an Intra State or an Inter-State supply.**

- **Intra-State supply of goods or services** is when the **location of the supplier** and the place of supply i.e., **location of the buyer** are in the **same state**. In Intra-State transactions, a seller has to **collect both CGST and SGST** from the buyer. The **CGST gets deposited with Central Government** and **SGST gets deposited with State Government.**
- **Inter-State supply of goods or services** is when the **location of the supplier** and the **place of supply** are in **different states**. Also, in cases of **export or import of goods or services** or when the supply of goods or services is **made to or by a SEZ unit**, the transaction is assumed to be Inter-State. In an Inter-State transaction, a **seller has to collect IGST from the buyer**.

8.1 What is Central Goods and Services Tax (CGST)?

Under GST, **CGST is a tax levied on Intra State supplies** of both **goods and services** by the **Central Government** and will be governed by the **CGST Act**. SGST will also be levied on the same Intra State supply but will be governed by the State Government.

This implies that both the Central and the State governments will agree on combining their levies with an appropriate proportion for revenue sharing between them. However, it is clearly mentioned in Section 8 of the GST Act that the taxes be levied on all Intra-State supplies of goods and/or services but the rate of tax shall not be exceeding 14%, each.

8.2 What is State Goods and Services Tax (SGST)?

Under GST, **SGST is a tax levied on Intra State supplies of both goods and services by the State Government** and will be governed by the **SGST Act.** As explained above, CGST will also be levied on the same Intra State supply but will be governed by the Central Government.

8.3 What is Integrated Goods and Services Tax (IGST)?

Under GST, IGST is a **tax levied on all Inter-State supplies of goods and/or services** and will be governed by the **IGST Act**. IGST will be applicable on any supply of goods and/or services in both cases of **import into India and export from India.**

Note: Under IGST,

- **Exports would be zero-rated**. (In economics, zero-rated supply refers to items subject to a 0% VAT tax on their input supplies.)
- Tax will be shared between the Central and State Government.

Five petroleum products have been kept out of GST for the time being but with passage of time, they will get subsumed in GST. State Governments will continue to levy VAT on **alcoholic liquor for human consumption. Tobacco and tobacco products** will attract both **GST and Central Excise Duty**.