2018

IASBABA

[LPG & GOVERNMENT BUDGETING-GS 3]

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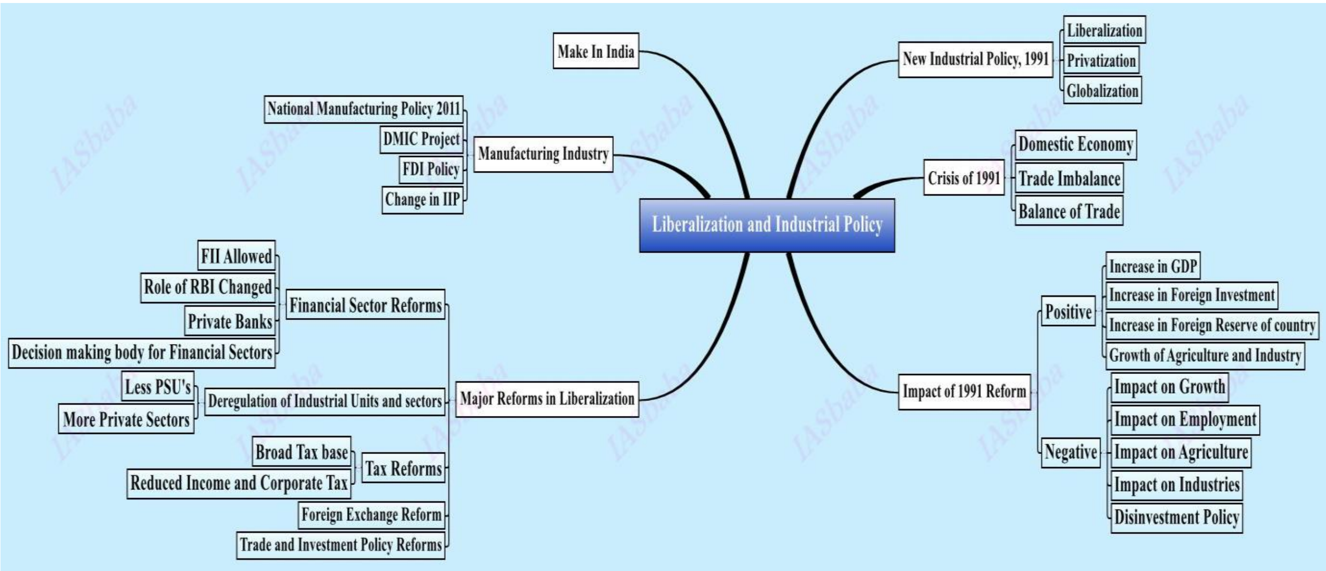
GS MAINS PAPER III

This document covers the following topics of UPSC Mains GS III Indian Economy syllabus:

General Studies- III:

- Liberalization, Privatization and Globalization- This topic was to be covered post Prelims but providing for better learning.
- Government Budgeting

Below provided mind map briefs us about the areas to be covered under each topic for Mains:



Mind Map Link: http://iasbaba.com/wp-content/uploads/2015/05/Liberalization-and-Industrial-Policy.jpg

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GOVERNMENT BUDGETING

NEW ECONOMIC POLICIES: LIBERALIZATION, PRIVATIZATION AND GLOBALIZATION

INTRODUCTION:

Since independence, India followed the **mixed economy framework** by combining the advantages of the capitalist economic system with those of the socialist economic system.

Some scholars argue that, over the years, this policy resulted in the establishment of a variety of rules and laws, which were aimed at controlling and regulating the economy, ended up instead in hampering the process of growth and development.

Others state that India, which started its developmental path from near stagnation, has since been able to achieve growth in savings, developed a diversified industrial sector which produces a variety of goods and has experienced sustained expansion of agricultural output which has ensured food security.

In 1991, India met with an **economic crisis** relating to its external debt —

- the government was not able to make repayments on its borrowings from abroad;
- foreign exchange reserves, which we generally maintain to import petrol and other important items, dropped to levels that were not sufficient for even a fortnight;
- The crisis was further compounded by rising prices of essential goods.

All these led the government to introduce a new set of policy measures which changed the direction of our developmental strategies.

BACKGROUND (Reasons for economic crisis and need for new set of policy measures)

The origin of the financial crisis can be traced from the inefficient management of the Indian economy in the 1980s. Government's expenditure was more than its income.

What happens when expenditure is more than income? →

- Government borrows to finance the deficit from banks and also from people within the country and from international financial institutions.
- Government had to overshoot its revenue to meet problems like unemployment, poverty and population explosion (revenues were very low; no chance of generating immediate returns) → No generation of additional revenue even via taxation.
- Income from public sector undertakings → was not very high to meet the growing expenditure.
- Government borrowed foreign exchange → Spent on meeting consumption needs.

Government neither made any attempt to reduce such profligate spending nor sufficient attention was given to boost exports to pay for the growing imports.

In the late 1980s,

- Government expenditure began to exceed its revenue by such large margins that meeting the expenditure through borrowings became unsustainable.
- There was sharp rise in the prices of many essential goods.
- Imports grew at a very high rate without matching growth of exports.
- Foreign exchange reserves declined to a level that was not adequate to finance imports for more than two weeks.
- No sufficient foreign exchange to pay the interest that needs to be paid to international lenders.

India took a step…

India approached the International Bank for Reconstruction and Development (IBRD)—World Bank and the International Monetary Fund (IMF) and received $7 billion as loan to manage the crisis.

How to avail the loan?

International agencies expected India to liberalize and open up the economy by

- Removing restrictions on the private sector
- Reducing the role of the government in many areas
- Removing trade restrictions

What did India do?

India agreed to the conditionality's of World Bank and IMF—announced the **New Economic Policy (NEP) –** which consisted of wide ranging economic reforms, such as:

- Creating a more competitive environment in the economy by removing the barriers to entry and growth of firms;
- Introduced liberalization with a view to integrate the Indian economy with the world economy;
- to remove restrictions on direct foreign investment as also to free the domestic entrepreneur from the restrictions of Monopolies and Restrictive Trade Practices (MRTP) Act;
- to unshackle the Indian industrial economy from the cobwebs of unnecessary bureaucratic controls;
- to shed the load of public sector enterprises which have shown a very low rate of return or which were incurring losses over the years.

The government initiated a variety of policies which fall under three heads: viz., liberalisation, privatisation and globalisation.

1991 ECONOMIC REFORMS: NEW ECONOMIC POLICIES

In 1990s the govt. of India in order to come out of the economic crisis decided to deviate from its previous economic policies and lean towards Privatization.

In July 1991 when the devaluation of Indian currency took place the govt. started announcing its new economic polices one after another. Though these polices pertained to different aspects of the economic field they had one thing in common.

The economic element was to orient the Indian system towards the world market. It is in this context the govt. launched its new economic policy which consisted of among other things **three important features**: **Liberalization**, **Privatization and Globalization**.

LIBERALISATION OF THE ECONOMY

CONCEPT OF LIBERALISATION

The term **"liberalization"** in this context implies economic liberalization. The essence of this policy is that *greater freedom is to be given to the entrepreneur of any industry, trade or business and that governmental control on the same be reduced to the minimum*.

Rules and laws which were aimed at regulating the economic activities became major hindrances in growth and development. Hence, Liberalisation was introduced to put an end to these restrictions and open up various sectors of the economy.

The main purpose of the process to economic liberalization is to set business free and to run on commercial lines. The underlying belief is that commerce and business are not matter to be contained to fixed national boundaries; they are global phenomena. Here, artificial govt. restrictions which hinder economic and commercial activities and flow of goods and services were removed. The liberalization intended to liberalize commerce and business and trade from the clutches of controls and obstacles.

MAIN FEATURES OF THE POLICY OF LIBERALISATION:

- Lessened Government control and freelance to private Enterprises.
- Capital Markets opened for private Entrepreneurs
- Simplification of Licensing policy
- Opportunity to purchase foreign exchange at market prices
- Right To Take Independent Decisions Regarding The Market
- Better opportunity for completion

- Widened Liberty in the Realm of Business and Trade

IMPORTANT MEASURES:

1. **Removal of Industrial Licensing:**
   - All industrial licensing was abolished except a shortlist of 18 industries related to security and strategic concerns, social reasons, hazardous chemicals and over-riding environmental reasons and items of elitist consumption industries reserved for the small scale sector which were to continue under the reservation list.
   - Subsequently, all industries except for a small group of five industries [**alcohol, cigarettes, hazardous chemicals industrial explosives, electronics, aerospace and drugs and pharmaceuticals**], industrial licensing requirements have been done away with.
   - **Reservations for Public sector:** defence equipment, atomic energy generation and railway transport.
   - Deregulation of goods produced in small scale industries.
   - Market mechanism to determine the prices.

2. **Financial Sector Reforms:**
   - Financial sector which includes financial institutions such as commercial banks, investment banks, stock exchange operations and foreign exchange market - are regulated by the Reserve Bank of India (RBI).
   - All the banks and other financial institutions in India are regulated through various norms and regulations of the RBI. RBI decided the amount of money that the banks can keep with themselves, fixed interest rates, nature of lending to various sectors etc.
   - One of the major aims of financial sector reforms is to reduce the role of RBI from regulator to facilitator of financial sector. i.e., the financial sector was allowed to take decisions on many matters without consulting the RBI.
   - For instance, the reform policies led to the establishment of private sector banks, Indian as well as foreign.

3. **Liberalization of Foreign Investment:**
   - While earlier prior approval was required by foreign companies, now automatic approvals were given for Foreign Direct Investment (FDI) to flow into the country.
   - A list of high-priority and investment-intensive industries were de-licensed and could invite up to 100% FDI including sectors such as hotel and tourism, infrastructure, software development .etc.
   - Use of foreign brand name or trade mark was permitted for sale of goods.

4. **Public Sector Reforms:**
   - Greater autonomy was given to the PSUs (Public Sector Units) through the MOUs (Memorandum of Understanding) restricting interference of the government officials and allowing their managements greater freedom in decision-making.

5. MRTP Act :

- The Industrial Policy 1991 restructured the Monopolies and Restrictive Trade Practices Act. Regulations relating to concentration of economic power, pre-entry restrictions for setting up new enterprises, expansion of existing businesses, mergers and acquisitions etc. have been abolished.

PRIVATISATION OF THE ECONOMY

CONCEPT OF PRIVATISATION:

Privatisation has to be viewed in two ways:

- In a narrow sense, it implies the induction of private ownership in a public sector undertaking.
- In a broader sense, it implies the enlargement of the scope of the private sector in the growth of the economy.

Privatization is closely associated with the phenomena of globalization and liberalization. Privatization is the transfer of control of ownership of economic resources from the public sector to the private sector. It means a decline in the role of the public sector as there is a shift in the property rights from the state to private ownership.

The public sector had been experiencing various problems, since planning, such as low efficiency and profitability, mounting losses, excessive political interference, lack of autonomy, labour problems and delays in completion of projects. Hence to remedy this situation with Introduction of NIP'1991 privatization was also initiated into the Indian economy.

CONCEPT OF DISINVESTMENT:

Another term for privatization is Disinvestment. The objectives of disinvestment were to raise resources through sale of PSUs to be directed towards social welfare expenditures, raising efficiency of PSUs through increased competition, increasing consumer satisfaction with better quality goods and services, upgrading technology and most importantly removing political interference.

Do you know?

- In the initial phase of development planning in India, more especially after the Industrial Policy of 1956, the socialisation of the economy was measured by the size of the public sector in the national economy. The greater the share of the public sector, the greater was the degree of socialisation of the economy.
- Under economic reforms after 1991, the main thrust is that the private sector is considered as the engine of growth. By placing restrictions on the public sector and by reducing its role in several areas where it earlier enjoyed a monopolistic position, the new environment assigned an increasing role for the private sector.

MAIN OBJECTIVES OF PRIVATIZATION

- The process of Privatization has been triggered with the main intention of improving industrial efficiency and to facilitate the inflow of foreign investments.
- It also wants to make the public sector undertakings strong able efficient companies. It recommends a change in the role of the government from that of the "owner manager" to that of a mere "controller" or "regular".
- It also intends to ensure efficient utilization of all types of resources including human resources.
- Privatization insists on the government to concentrate on the area such as education administration and infrastructure and to give up the responsibility of looking after business and running industries. It is expected to strengthen the capital market by following appropriate trade policies.

IMPORTANT MEASURES:

The main aspects of privatization in India are as follows:

1. **Autonomy to Public sector:**
   - Greater autonomy was granted to nine PSUs referred to as 'navaratnas' (ONGC, HPCL, BPCL, VSNL, BHEL) to take their own decisions.

2. **De-reservation of Public Sector:**
   - The numbers of industries reserved for the public sector were reduced in a phased manner from 17 to 8 and then to only 3 including Railways, Atomic energy, specified minerals.
   - This has opened more areas of investment for the private sector and increased competition for the public sector forcing greater accountability and efficiency.

3. **Disinvestment Policies:**
   - Till 1999-2000 disinvestment was done basically through sale of minority shares but since then the government has undertaken strategic sale of its equity to the private sector handing over complete management control such as in the case of VSNL , BALCO etc.

4. **Joint Venture:**
   - This implies partial induction of private ownership from 25 to 50 per cent or even more in a public sector enterprise, depending upon the nature of the enterprise and state policy in this regard.

   Three kinds of proposals have been put forward:

   i) 26 per cent ownership by the private sector (banks, mutual funds, corporations, or individuals) and workers also to be included to the extent of 5 per cent equity to be transferred to them. However, in this situation, veto power remains with the public sector against the private sector.

ii) Government retains 51 per cent equity and sells 49 per cent equity to the private sector. Although the basic character of the enterprise remains unaltered and it continues to be a public sector unit, it introduces a big share for the private sector.

iii) 74 per cent of the equity is transferred to the private sector and the Government retains 26 per cent with the added provision of Government veto power and minority control over major corporate decisions.

These three variants of privatization indicate different degrees of ownership by the private sector in the joint venture. The basic aim of the transfer of ownership is that it will enable the joint venture to improve productivity of assets and convert them into profitable concerns.

ARGUMENTS IN FAVOUR OF PRIVATIZATION

- Privatization is Necessary to Revitalize the State Owned Enterprises
- Privatization is Necessary to Face Global Competition
- Privatization is Needed to Create More Employment Opportunities in Future
- Helpful for Mobilizing and Investing Resources
- Recognition of Talents and Good Performance of work

ARGUMENT AGAINST PRIVATIZATION

- Profitability Alone Should Not Become the Sole Yardstick to Measure Efficiency
- Role of Public Sector Undertaking From the socio-Economic Angle Also Cannot be ignored
- Protection of the Interests of the Weaker Section
- Price –fixing Policy Here is Not Profit- Oriented
- Argument that the Private Sector Is More Efficient than the Public Sector is Not Right

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GLOBALISATION TO INTEGRATE THE INDIAN ECONOMY WITH THE WORLD ECONOMY

CONCEPT OF GLOBALISATION:

Globalization essentially means integration of the national economy with the world economy. It implies a free flow of information, ideas, technology, goods and services, capital and even people across different countries and societies. It increases connectivity between different markets in the form of trade, investments and cultural exchanges.

The concept of globalization has been explained by the IMF (International Monetary Fund) as 'the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology.'

MAINS ELEMENTS OF GLOBALISATION:

The phenomenon of globalization caught momentum in India in 1990s with reforms in all the sectors of the economy. The main elements of globalization were:

1. To open the domestic markets for inflow of foreign goods, India reduced customs duties on imports. The general customs duty on most goods was reduced to only 10% and import licensing has been almost abolished. Tariff barriers have also been slashed significantly to encourage trade volume to rise in keeping with the World trade Organization (WTO) order under (GATT) General Agreement on Tariff and Trade.
2. The amount of foreign capital in a country is a good indicator of globalization and growth. The FDI policy of the GOI encouraged the inflow of fresh foreign capital by allowing 100 % foreign equity in certain projects under the automatic route. NRIs and OCBs (Overseas Corporate Bodies) may invest up to 100 % capital with repatriability in high priority industries. MNCs and TNCs were encouraged to establish themselves in Indian markets and were given a level playing field to compete with Indian enterprises.
3. Foreign Exchange Regulation Act (FERA) was liberalized in 1993 and later Foreign Exchange Management Act (FEMA) 1999 was passed to enable foreign currency transactions.
4. India signed many agreements with the WTO affirming its commitment to liberalize trade such as TRIPs (Trade Related Intellectual Property Rights), TRIMs (Trade Related Investment Measures) and AOA (Agreement on Agriculture).

IMPACT OF GLOBALISATION:

Advantages of Globalization:

- There is a decline in the number of people living below the poverty line in developing countries due to increased investments, trade and rising employment opportunities.
- There is an improvement in various economic indicators of the LDCs (Less Developed Countries) such as employment, life expectancy, literacy rates, per capita consumption etc.
- Free flow of capital and technology enables developing countries to speed up the process of industrialization and lay the path for faster economic progress.
- Products of superior quality are available in the market due to increased competition, efficiency and productivity of the businesses and this leads to increased consumer satisfaction.
- Free flow of finance enable the banking and financial institutions in a country to fulfill financial requirements through internet and electronic transfers easily and help businesses to flourish.
- MNCs bring with them foreign capital, technology, know-how, machines, technical and managerial skills which can be used for the development of the host nation.

Disadvantages of Globalisation:

- Domestic companies are unable to withstand competition from efficient MNCs which have flooded Indian markets since their liberalized entry. It may lead to shut down of operations, pink slips and downsizing.
- Moreover skilled and efficient labours get absorbed by these MNCs that offer higher pay and incentives leaving unskilled labour for employment in the domestic industries. Thus there may be unemployment and underemployment.
- Payment of dividends, royalties and repatriation has in fact led to a rise in the outflow of foreign capital.
- With increased dependence on foreign technology, development of indigenous technology has taken a backseat and domestic R and D development has suffered.
- Globalization poses certain risks for any country in the form of business cycles, fluctuations in international prices, specialization in few export tables and so on.
- It increases the disparities in the incomes of the rich and poor, developed nations and LDCs. It leads commercial imperialism as the richer nations tend to exploit the resources of the poor nations.
- Globalization leads to fusion of cultures and inter-mingling of societies to such an extent that there may be a loss of identities and traditional values. It gives rise to mindless aping of western lifestyles and mannerisms however ill-suited they may be.
- It leads to overcrowding of cities and puts pressure on the amenities and facilities available in urban areas.

ADVOCACY OF GLOBAISATION

In support of the movement for globalisation, the following arguments are put forth:

1. Globalisation promotes foreign direct investment and, thus, it enables developing countries to raise capital without incurring international indebtedness.
2. Globalisation helps developing countries to make use of and adapt technologies developed by advanced countries without undertaking heavy expenditures in Research and Development (R&D).
3. Globalisation widens the access of developing countries to export their goods and services to developed countries. Similarly, globalisation enables consumers in developing countries to acquire quality consumer goods, especially consumer durables, at relatively much lower prices.
4. Globalisation implies faster diffusion of knowledge and, thus, it enables developing countries to attain international standards of production and productivity.
5. Globalisation by reducing tariffs and quantitative restriction increases the share of foreign trade as a percentage of GDP.

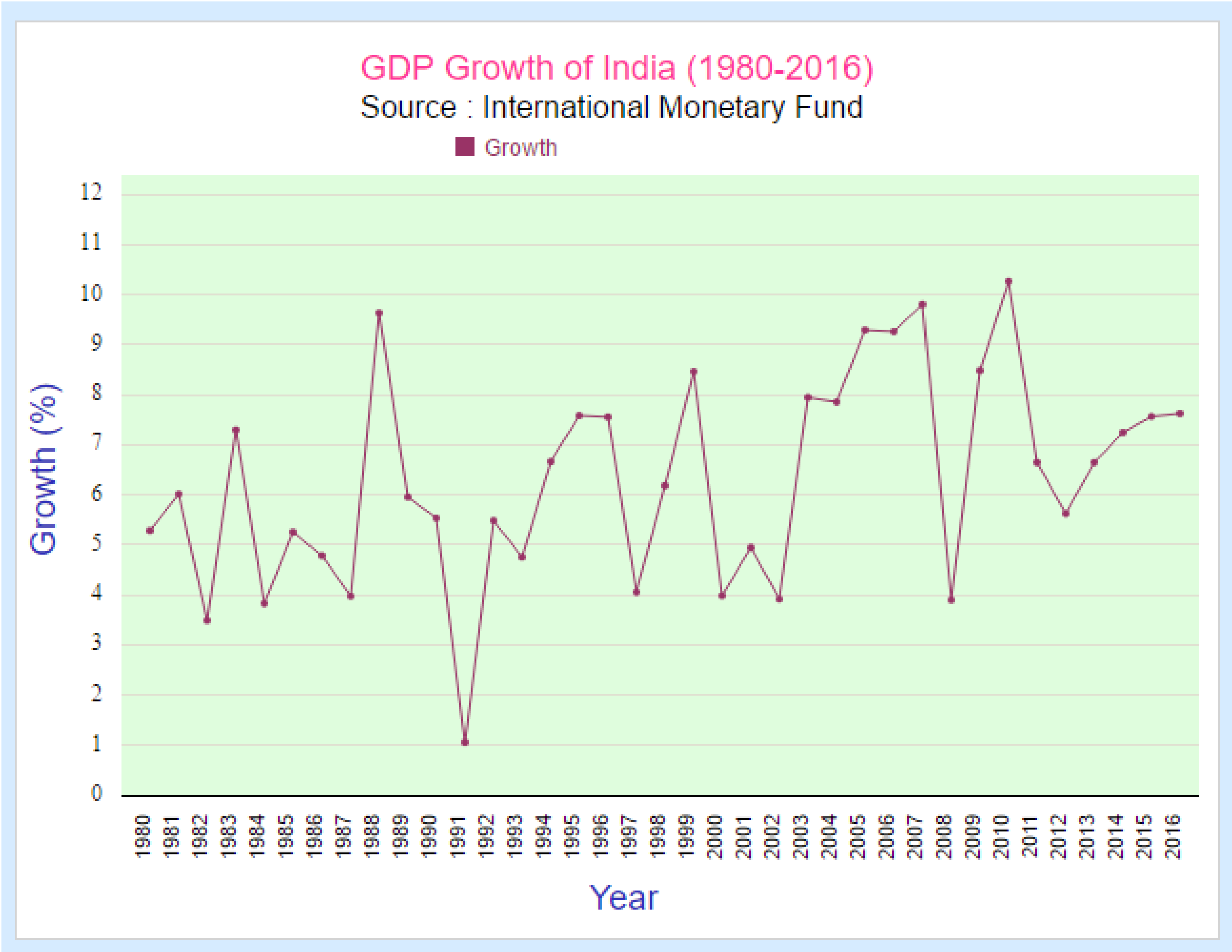
In brief, the advocates of globalisation consider it as the engine of growth, technological advancement, raising levels of productivity, enlarging employment and bringing about poverty reduction with modernisation.

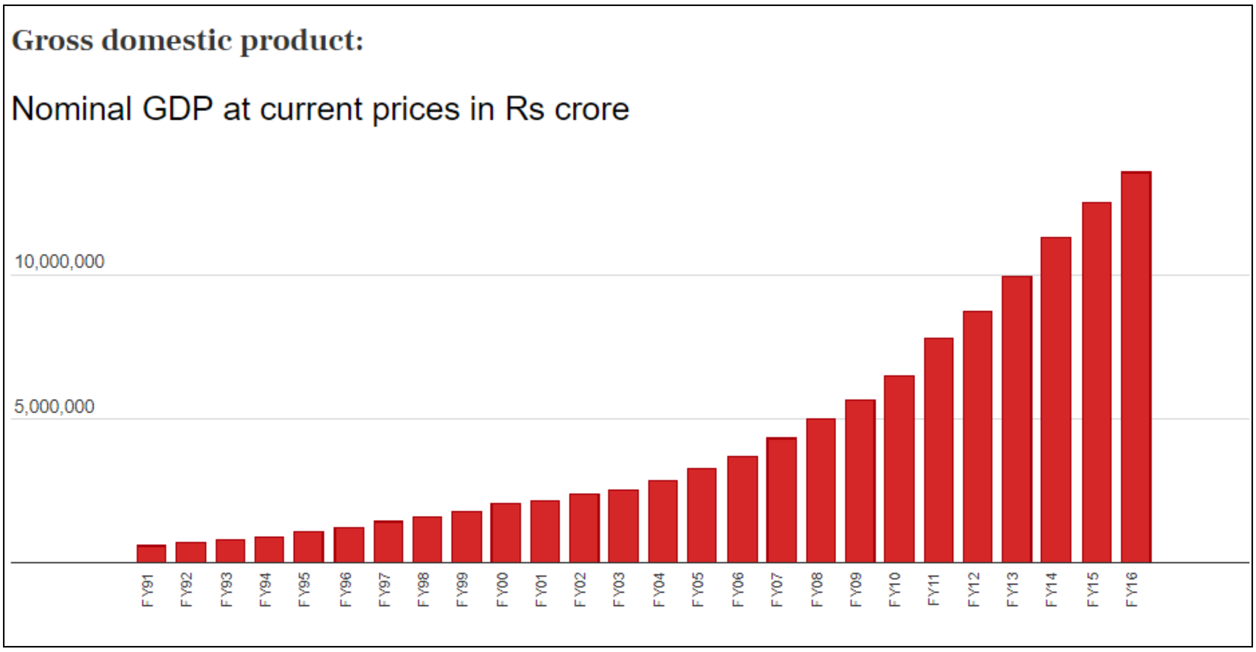
POSITIVE IMPACT OF LPG REFORMS ON INDIAN ECONOMY

Following are some of the positive impacts of LPG Reforms on Indian Economy

1. Increase in GDP growth rate

- India's GDP growth rate is increased. During 1990-91 India's GDP growth rate was only 1.1% but after 1991 reforms due LPG policy India's GDP growth rate is increased year by year and in 2017 it was recorded 7.2 and in 2016-17 it was estimated to be 7-7.5% by IMF.
- Because of the Abolition of Industrial licensing, privatisation, advanced foreign technology and Reduction of taxes India's GDP is increased after 1991 reforms.





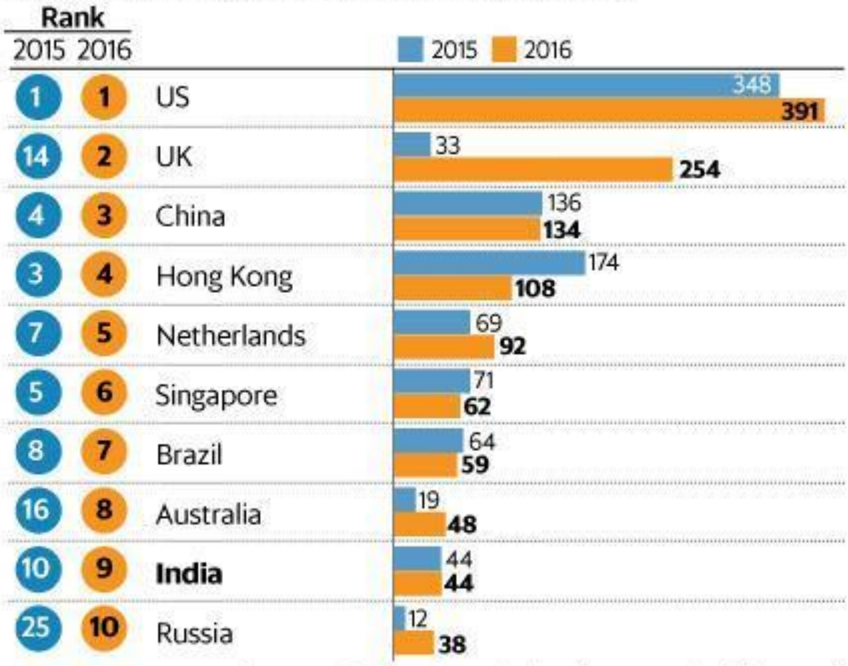
2. Increase in Foreign Direct Investment (FDI):

- India has already marked its presence as one of the fastest growing economies of the world.
- It has been ranked among the top 3 attractive destinations for inbound investments.
- Since 1991, the regulatory environment in terms of foreign investment has been consistently eased to make it investor-friendly.
- India has also firmly established itself as a lucrative foreign investment destination. Foreign direct investment inflows hit an all-time high of $60.1 billion in 2016-17.
- India's forex reserves have been rising with a total accretion of $4.389 billion to the kitty since 14 July 2017. It had touched a record high of $393.448 billion after it rose by $581.1 million in the week to 4 August 2017.
- India has allowed 100% FDI in medical services, Telecom sector, and single brand retail etc.
- Read this- **Click Here**

INDIA RANKED NO. 9 ON FDI INFLOWS IN 2016

India improved its ranking by one notch to No. 9 in terms of foreign direct investment (FDI) received in 2016, at a time global FDI flows fell, the UN Conference on Trade and Development (Unctad) said in its latest World Investment Report. While the US remained the top host country for FDI in 2016 with $391 billion inflows, and the UK saw an unprecedented rise from $33 billion in 2015 to $254 billion in 2016, inflows to India grew 1% to $44.5 billion. A drop in inflows to France, which was No. 9 last year, improved India's ranking, said the annual report.

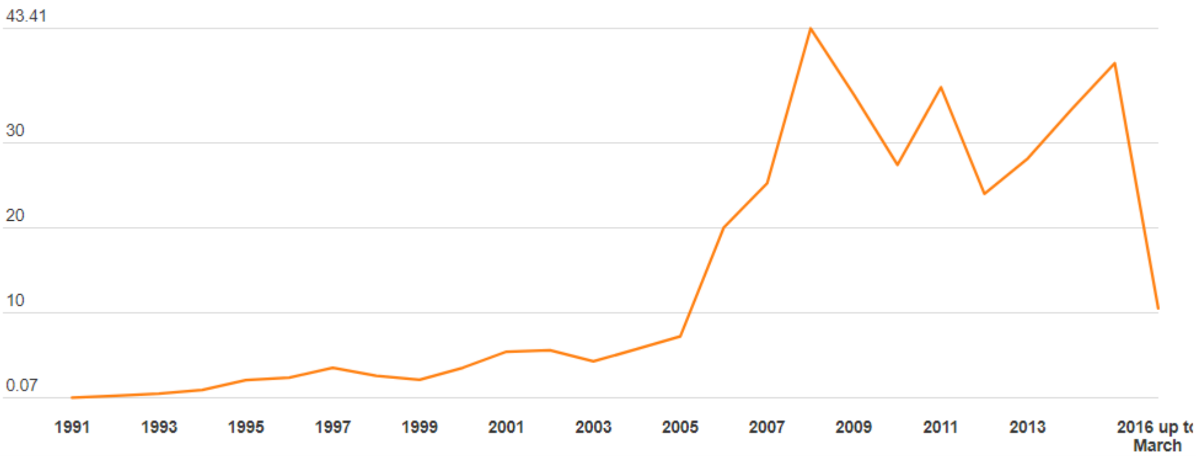
FDI inflows, top 10 host economies (in $ bn)

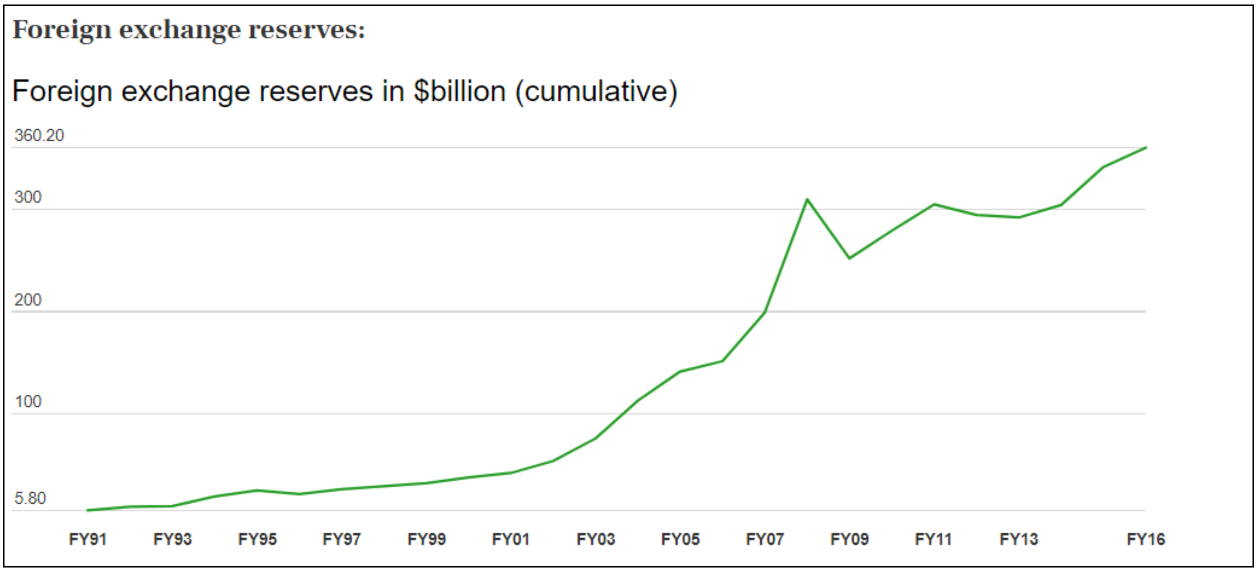


Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics)

Foreign direct investment

Foreign direct investments in $ billion



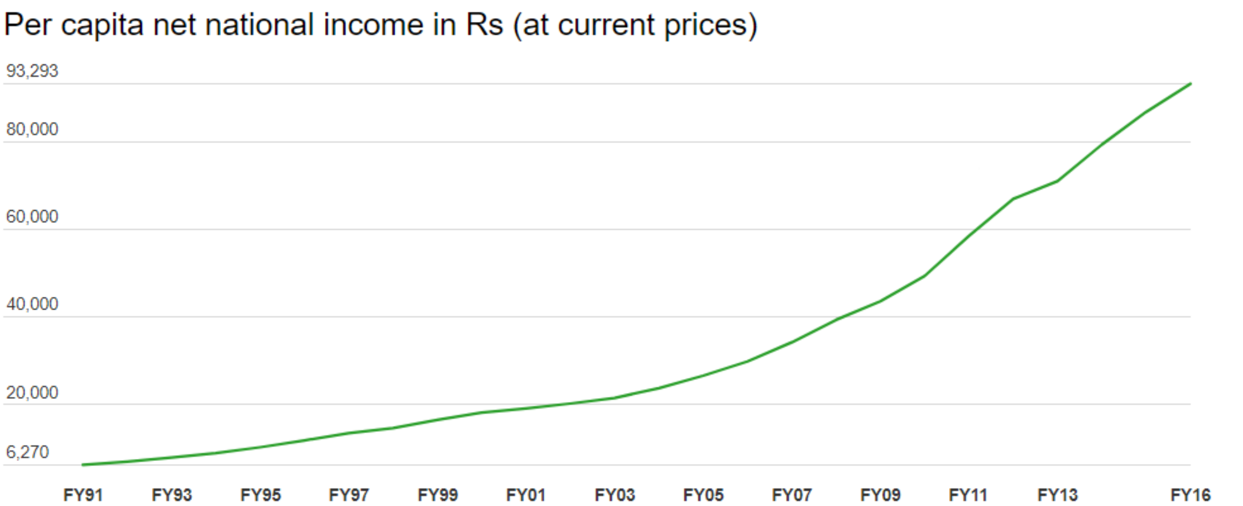


3. Increase in per capita income-

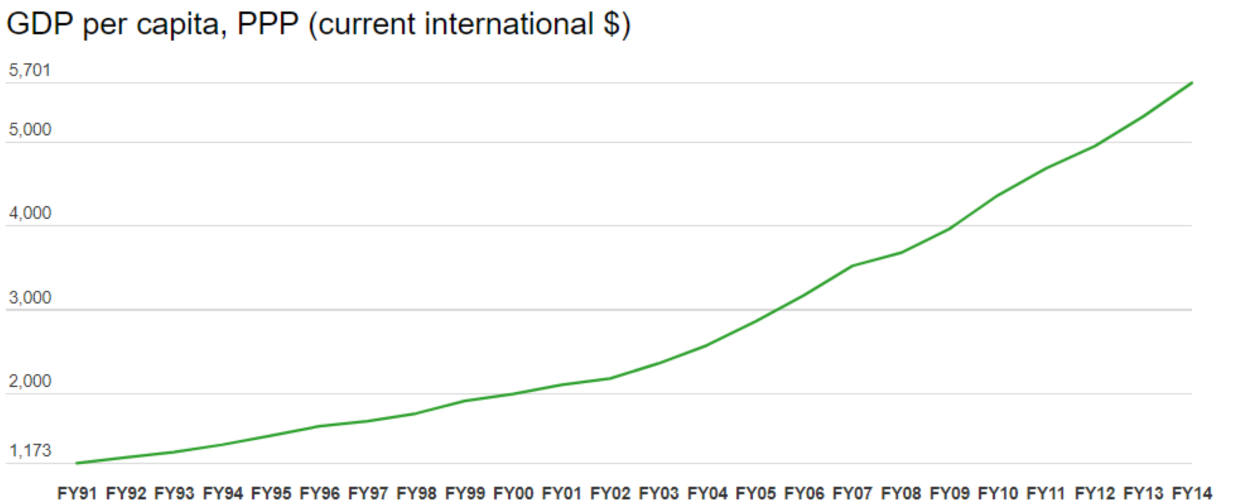
- Per capita income or average income measures the average income earned per person in a given area (city, region, country, etc.).
- It is calculated by dividing the area's total income by its total population.
- In 1991 India's Per capita Income was Rs. 11235 but in 2014-15 Per Capita Income is reached to Rs. 85533.
- Per Capita income is increased due to Increase in Employment, due to new economy policy of globalization and privatization many job opportunities are created so, and people's income was increased.

Year	Per Capita Income
1991	Rs.11535
2011-12	Rs.64,316
2012-13	Rs.71,593
2013-14	Rs. 80,388

Per capita income:



Purchasing power parity:



4. **Unemployment rate is reduced-**

- In 1991 unemployment rate was 4.3% but after India adopted new LPG policy more employment is generated. Because of globalization many new foreign companies came in India and due to liberalization many new entrepreneurs have started new companies because of an abolition of Industrial licensing / Permit Raj so, employment is generated, and due to which India's unemployment rate is reduced from 4.3% in 1991 to 3.6% in 2014. However recent trends shows an increase in unemployment rate. "**Unemployment in India is projected to increase from 17.7 million last year to 17.8 million in 2017"- United Nations, ILO**

5. **Privatization has resulted into reduction of the government's financial and administrative burden.**

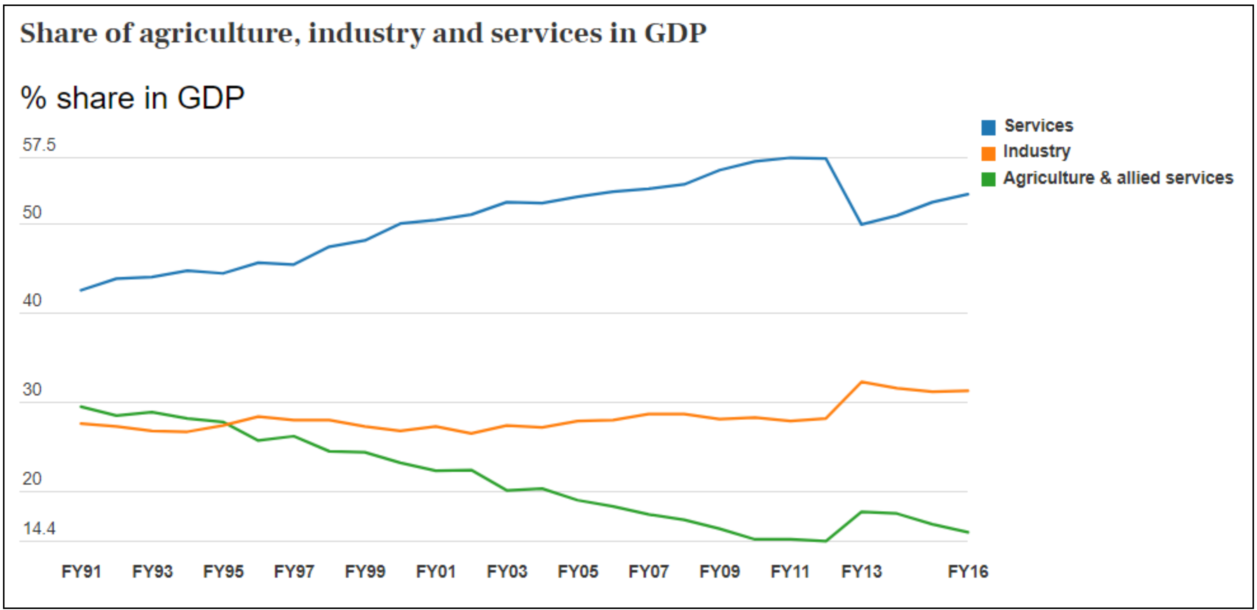
LIMITATIONS OF LPG POLICY ON INDIAN ECONOMY

1. Low Growth of Agriculture Sector-

- Agriculture has been and still remains the backbone of the Indian economy. It plays a vital role not only in providing food and nutrition to the people, but also in the supply of raw material to industries and to export trade.
- In 1991, agriculture provided employment to 72 per cent of the population and contributed 29.02per cent of the gross domestic product. However, in 2014 the share of agriculture in the GDP went down drastically to17.9 per cent. This has resulted in a lowering the per capita income of the farmers and increasing the rural indebtedness.

GDP compositions in 2017 are as follows:

- Agriculture (16.5%)
- Industry (29.8%) and
- Services (45.4%) - **(2016 est.)**



2. Threat from foreign competition-

- Due to opening up of the Indian economy to foreign competition through Liberalization and FDI policy more MNC's are attracted towards India after 1991 reforms and they are competing local businesses and companies.
- Since, these MNC's have lots of financial capacity or those are big organizations with advanced foreign technology so, they have large production capacity and huge money for promotion and other research activities they are easily defeating our Indian local companies. And they had acquired many Indian companies as well.
- Because of financial constraints, lack of advanced technology and production inefficiencies our Indian companies are facing problem in this globalization period.

3. **Adverse Impact on Environment-**

- Globalization has also contributed to the destruction of the environment through pollution and clearing of vegetation cover.
- With the construction of companies, the emissions from manufacturing plants are causing environmental pollution which further affects the health of many peoples.
- The construction also destroys the vegetation cover which is important in the very survival of both humans and other animals.

4. **Increase in Income disparity-**

- Globalization leads to widening income gaps within the country. Globalization benefits only to those who have the skills and the technology in the country.
- The higher growth rate achieved by an economy can be at the expense of declining incomes of people who may be rendered redundant.
- Globalization has widened the gap between the rich and poor, rises inequalities.

5. **Growth and Employment:**

- Though the GDP growth rate has increased in the reform period, scholars point out that the reform-led growth has not generated sufficient employment opportunities in the country.

CONCLUSION

Economic reforms have an important impact on Indian economy. There are many changes in Indian economy, after adaptation of the policy of LPG i.e. Liberalisation, Privatisation and Globalisation in 1991.

Because of these reforms many good thing are happen like increase in the India's GDP growth rate, Foreign direct Investment and Per Capita Income. Policy has facilitated the flow of foreign capital, technology and managerial expertise thereby improving efficiency of industry. Also, unemployment rate is reduced.

The process of globalisation through liberalisation and privatisation policies has produced positive as well as negative results both for India and other countries. Some scholars argue that globalisation should be seen as an opportunity in terms of greater access to global markets, high technology and increased possibility of large industries of developing countries to become important players in the international arena.

On the contrary, the critics argue that globalisation is a strategy of the developed countries to expand their markets in other countries. According to them, it has compromised the welfare and identity of people belonging to poor countries. It has further been pointed out that market-driven globalisation has widened the economic disparities among nations and people.

Viewed from the Indian context, some studies have stated that the crisis that erupted in the early 1990s was basically an outcome of the deep-rooted inequalities in Indian society and the economic reform policies initiated as a response to the crisis by the government, with externally advised policy package, further aggravated the inequalities.

Further, it has increased the income and quality of consumption of only high-income groups and the growth has been concentrated only in some select areas in the services sector such as telecommunication, information technology, finance, entertainment, travel and hospitality services, real estate and trade, rather than vital sectors such as agriculture and industry which provide livelihoods to millions of people in the country.

Though there are certain negative impacts are also there like low growth of agriculture sector, adverse impact on environment etc. Lastly we can say that development in India is taking place because of implementation of this policy.

For further reference you can go through the below link:

25 years of liberalisation: A glimpse of India's growth in 14 charts

25 Years of Economic Liberalisation- Big Picture

Mains Questions 2016

1. **How globalization has led to the reduction of employment in the formal sector of the Indian economy? Is increased informalization detrimental to the development of the country?**

2. **Has the Indian governmental system responded adequately to the demands of Liberalization, Privatization and Globalization started in 1991? What can the government do to be responsive to this important change?**

GOVERNMENT BUDGETING

WHAT IS A GOVERNMENT BUDGET?

A government budget is a statement of expected expenditure of the government and the sources of financing the expenditure during a financial year. Such an exercise is undertaken much before the financial year starts. The statement details all expenditures to be incurred during the coming financial year and the sources of meeting this expenditure.

In India, government budget is normally presented in the Parliament in the month of February every year.

The budget of a government is a summary of the item-wise intended/expected revenues and anticipated expenditures of the government during a fiscal year/financial year.

Government at all levels, whether central, state or a local level, prepare the budget. Budget is prepared, keeping in view the general policy of government towards the welfare of people.

Main elements of the budget:

(i) It is a statement of estimates of government receipts and expenditure.

(ii) Budget estimates pertain to a fixed period, generally a year.

(iii) Expenditure and sources of finance are planned in accordance with the objectives of the government.

(iv) It requires to be approved (passed) by Parliament or Assembly or some other authority before its implementation.

Objectives of a Government Budget:

In a mixed economy like ours, the government plays a significant role along with the private sector. The three major functions served by this presentation of estimates.

- **Allocation function:** Public goods (national defense, roads, government administration, measures of lower air pollution, etc.) can't be provided by Market Mechanism (transaction between individuals).
- **Distribution function:** Government can alter income distribution by making transfer payments and collecting taxes, therefore affecting personal disposable income of households. Thus, through its tax and expenditure policy government tries to achieve a fair income distribution in society.
- **Stabilization function:** Fluctuations in economy may lead to inflation and unemployment. Government policy measures to stabilize domestic economy.

COMPONENTS OF THE GOVERNMENT BUDGET

There is a constitutional requirement in India (Article 112) to present before the Parliament a statement of estimated receipts and expenditures of the government in respect of every financial year which runs from 1 April to 31 March. This 'Annual Financial Statement' constitutes the main budget document. Further, the budget must distinguish expenditure on the revenue account from other expenditures. Therefore, the budget comprises of the (a) Revenue Budget and the (b) Capital Budget (Refer Chart 1 below).

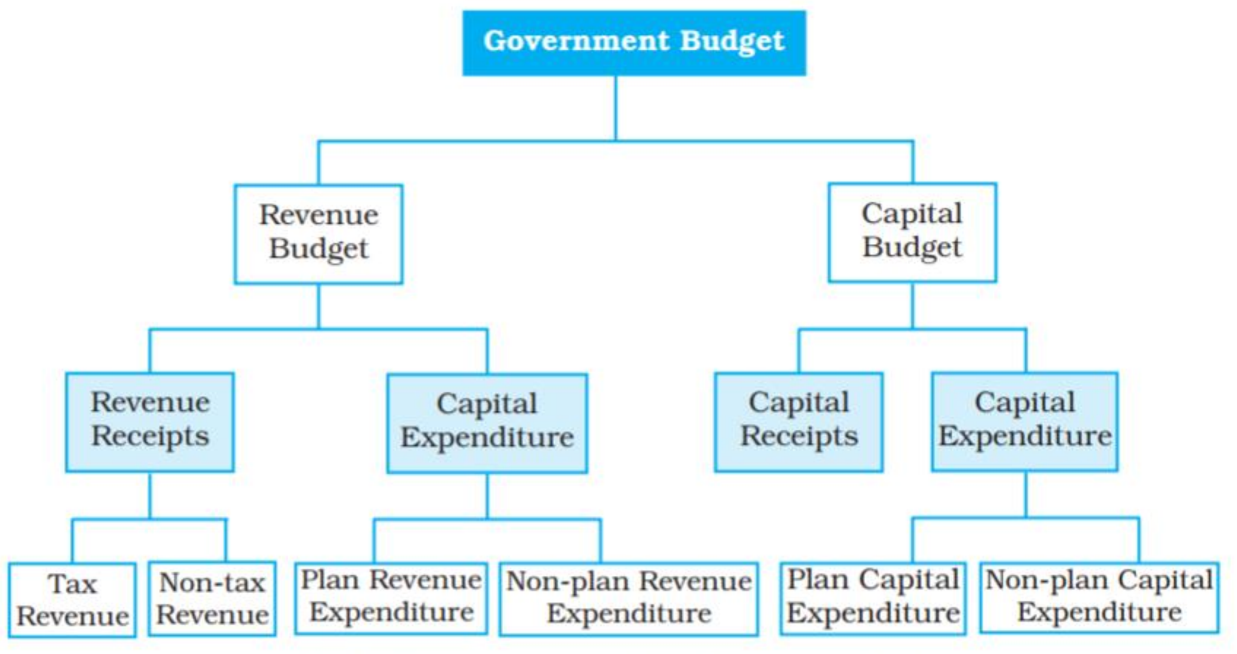


Chart 1: The Components of the Government Budget

The Revenue Account

The Revenue Budget shows the current receipts of the government and the expenditure that can be met from these receipts.

Revenue Receipts: Revenue receipts are divided into tax and non-tax revenues.

Tax Revenue:

- Tax revenues consist of the proceeds of taxes and other duties levied by the central government. Tax revenues, an important component of revenue receipts, comprise of direct taxes – which fall directly on individuals (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.
- Excise taxes are the single largest revenue earner. Other direct taxes like wealth tax, gift tax and estate duty (now abolished) have never been of much significance in terms of revenue yield and have thus been referred to as 'paper taxes'.

Non Tax Revenue:

Non Tax Revenue includes interest receipts on loans given by central government, dividends or profits in investment of government, fees & other receipts for services rendered by government. Also, cash grants-in-aid received from foreign countries and international organizations.

Revenue Expenditure:

Expense other than creation of physical or financial assets of central government, which means expenditure for normal functioning of government departments (day to day working)

- interest payments on debt taken by government
- grants to state government and others(even for creation of assets).

Capital Budget of Government of India:

Assets and liabilities of central government. Changes occurring capital is considered, shows capital requirements of government and pattern of their financing.

Capital Receipts:

Receipts creating liabilities, and reducing financial assets. These are:

- Market Borrowings: Loans raised from public.
- Treasury Bills: Borrowings from RBI and other commercial banks and FIs through treasury bills.
- Loans received from foreign government and international organisation.
- Recoveries of loans granted by central government.
- Small savings in PO savings account, National Saving Certificate, etc.
- Provident Fund
- PSU disinvestment (receipts from sale pf share in Public Sector Undertakings).

Capital Expenditure:

Expense which result in creation of physical or financial asset. Reduction in financial liabilities. They are:

- Expenditure on Land acquisition, building machinery, equipment.
- Investment in shares
- Loans & advances by Central government to states and UTs, PSUs or others.

BUDGET DEFICIT

- When a government spends more than it receives by the way of revenue, it is known as the **budget deficit.**
- The difference between revenue expenditure and revenue receipts is known as the **revenue deficit.**

- The difference between the government's total expenditure and its total receipts excluding borrowing is known as the **fiscal deficit**.
- The growth of revenue deficit as a percentage of fiscal deficit points to a deterioration in the quality of government expenditure involving lower capital formation.
- Government deficit can be reduced by an increase in taxes or/and reduction in expenditure.
- Public debt is burdensome if it reduces the future growth in terms of output.

TYPES OF BUDGETING

1. Performance Budgeting

- A performance budget reflects the goal/objectives of the organization and spells out its performance targets.
- These targets are sought to be achieved through a strategy. Unit costs are associated with the strategy and allocations are accordingly made for achievement of the objectives.
- A Performance Budget gives an indication of how the funds spent are expected to give outputs and ultimately the outcomes.
- However, performance budgeting has a limitation – it is not easy to arrive at standard unit costs especially in social programmes, which require a multi-pronged approach.

2. Zero-based Budgeting

- The basic purpose of ZBB is phasing out of programmes/activities, which do not have relevance anymore. ZBB is done to overhaul the functioning of the government departments and PSUs so that productivity can be increased and wastage can be minimized. Scarce government resources can be deployed efficiently. Therefore, Zero Based Budgeting is followed for rationalization of expenditure.
- The concept of zero-based budgeting was introduced in the 1970s. As the name suggests, in the process every budgeting cycle starts from scratch.
- Unlike the earlier systems, where only incremental changes were made in the allocation, under zero-based budgeting every activity is evaluated each time a budget is made and only if it is established that the activity is necessary, funds are allocated to it.
- Under the ZBB, a close and critical examination is made of the existing government programmes, projects and other activities to ensure that funds are made available to high priority items by eliminating outdated programmes and reducing funds to the low priority items.
- Governmental programmes and projects are appraised every year as if they are new and funding for the existing items is not continued merely because a part of the project cost has already been incurred.

3. Programme Budgeting

- Programme budgeting aimed at a system in which expenditure would be planned and controlled by the objective. The basic building block of the system was classification of expenditure into programmes, which meant objective-oriented classification so that programmes with common objectives are considered together.

4. Programme and Performance Budgeting System (PPBS)

- PPBS went much beyond the core elements of programme budgeting and was much more than the budgeting system. It aimed at an integrated expenditure management system, in which systematic policy and expenditure planning would be developed and closely integrated with the budget. Thus, it was too ambitious in scope.
- Neither was adequate preparation time given nor was a stage-by-stage approach adopted. Therefore, this attempt to introduce PPBS in the federal government in USA did not succeed, although the concept of performance budgeting and programme budgeting endured.
- Many governments today use the "programme budgeting" label for their performance budgeting system. As pointed out by Marc Robertson, the contemporary influence of the basic programme budgeting idea is much wider than the continuing use of the label. It is defined in terms of its core elements as mentioned above. Programme budgeting is an element of many contemporary budgeting systems which aim at linking funding and results.

5. Outcome Budget

- The Outcome Budget is a progress card on what various ministries and departments have done with the outlay announced in the annual budget.
- It is a performance measurement tool that helps in better service delivery; decision-making; evaluating programme performance and results; communicating programme goals; and improving programme effectiveness.
- The Outcome Budget is likely to comprise scheme- or project-wise outlays for all central ministries, departments and organizations during 2005-06 listed against corresponding outcomes (measurable physical targets) to be achieved during the year.
- It measures the development outcomes of all government programmes. The Outcome Budget, however, will not necessarily include information of targets already achieved.
- This method of monitoring flow of funds, implementation of schemes and the actual results of the usage of the money is followed by many countries.

6. Gender Budgeting

- The 2005-06 Budget introduced a statement highlighting the gender sensitivities of the budgetary allocations.
- Gender budgeting is an exercise to translate the stated gender commitments of the government into budgetary commitments, involving special initiatives for empowering women and examination of the utilization of resources allocated for women and the impact of public expenditure and policies of the government on women.

BALANCED AND UNBLANCED BUDGETS

A. Balanced Budgeting

- A Balanced Budget is that budget in which Government receipts are equal to Government expenditure.

Merits of the Balanced Budget

1. The Government does not indulge in wasteful expenditure.
2. Interference in economic functioning of the system is totally avoided by the government generally.
3. Financial stability is ensured with balanced budget.
4. However, balanced budget is not an achievement of the government when economy is in a state of depression for at that time, government is expected to increase its expenditure with a view to increasing aggregate demand.

Demerits of a Balanced Budget

1. Balanced budget does not offer any solution to the problem of unemployment during depression.
2. Balanced budget is not helpful to the growth and development programmes of the less developed countries.

B. Unbalanced Budgeting

- An unbalanced budget is that budget in which receipts and expenditure of the government are not equal.
- In this, two cases concerning surplus Budget and Deficit Budget arise.
- In Surplus Budget, Government receipts are greater than Government expenditures. While in the case of Deficit Budget, Government expenditures are greater than Government receipts.

Merits of a Deficit Budget

(i) It helps in addressing the problem of unemployment during depressions.
(ii) It is conducive for growth and development in less developed countries
(iii) It works towards social welfare of the people.

Demerits of Deficit Budget

(i) It shows wasteful expenditure by the government.
(ii) It shows less revenue realization in comparison with the expenditure.
(iii) It increases debt burden of the government.

Women empowerment in India needs gender budgeting. What are the requirements and status of gender budgeting in the Indian context? UPSC Mains 2016

For further reading, refer – GOVERNMENT BUDGETING (NIOS Material)
http://download.nos.org/318courseE/L-21%20GOVERNMENT%20BUDGETING.pdf

Also, refer to Key Features of Union Budget 2017-2018- Click Here