Revision Notes

Class 12 - Macroeconomics

Chapter 5 - Government Budget and the Economy

Budget: A budget is a year-long financial report that explains how future revenue and expenditure will be calculated item-wise. The budget details a country's revenue and expenditures.

Main objectives of the budget are:

- Resource reallocation.
- Income and wealth redistribution
- Public-sector management
- Economic Stability
- Economic Development
- Employment Creation

Two components of budget:

1. Revenue budget: The revenue budget is made up of the government of India's revenue receipts and the expenditures that are met with that revenue.

2. Capital budget: Capital receipts and payments are included in the capital budget. It also includes transactions from the Public Account.

Budget Receipts

1. Revenue Receipts: Revenue receipts are those that do not result in a liability or a decrease in assets. The revenue is then split into two categories.

- Receipt from tax

a. Direct tax: A taxpayer pays direct taxes in full to the government. It is also characterised as a tax in which the individual bears both the duty and the burden of payment. According to the type of tax charged, both the central government and state governments collect direct taxes.

b. Indirect tax: The end-consumer of products and services is ultimately responsible for indirect taxes. It is impossible to avoid because taxes are levied

on both products and services. It entails lower administrative costs as a result of convenient and regular collections.

- Receipt from non-tax: These include interest, commercial revenue, external grants, fines, penalties, and so on.

2. Capital Receipts: Capital receipts are government receipts that create liability or deplete financial assets. The main sources of capital receipts are loans from the public, also known as market borrowings, as well as borrowings from the Reserve Bank, commercial banks, and some other financial institutions through the sale of treasury bills, borrowings from foreign governments and international organisations, and loan recoveries. Small savings, provident funds, and net receipts from the sale of shares in Public Sector Undertakings are among the other items (PSUs).

Budget Expenditure

1. Revenue expenditure: The nature of revenue expenditure is generally current or short-term. They are costs that the government must incur to carry out its daily operations. These costs are fully charged in the year they are incurred and are not depreciated over time. They might either be recurring or non-recurring.

2. Capital Expenditure: Capital expenditures are one-time investments of money or capital made by a government for the aim of expanding in various sectors and businesses in order to create profits. These funds are typically used to acquire fixed assets or assets with a longer lifespan. These include machinery, manufacturing equipment, and infrastructure-improvement equipment. These assets provide value to the government during their entire lifespan and may or may not have a salvage value.

Budget Deficit: The amount by which a budget's expenditures exceed its revenue is referred to as a budget deficit. This deficit is a good indicator of the economy's financial health.

Revenue deficit: Revenue deficit is defined as the difference between total revenue collected and total revenue expenditure. Only current income and current expenses are included in this deficit. A large deficit figure implies that the government should reduce its spending. The government may be able to boost revenue by raising tax revenue.

Revenue deficit = Total revenue expenditure – Total revenue receipts

Implications of Revenue Deficit are:

- A significant revenue shortfall indicates budgetary indiscipline.
- It indicates that the government is dissaving, i.e., the government is utilising savings from other sectors of the economy to pay its consumer expenditure.
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- It demonstrates the government's excessive expenditures on administration.
- It lowers the government's assets owing to disinvestment.
- A significant revenue deficit sends a warning signal to the government to either cut spending or boost revenue.

Fiscal Deficit: A fiscal deficit occurs when the government's total expenditures exceed its entire revenue produced. The government's borrowings, however, are not included.

Fiscal deficit = Total expenditure – Total receipts excluding borrowings

Implications of Fiscal Deficits are:

- A significant drawback or consequence of fiscal deficit is that it may result in a debt trap.
- It causes inflationary pressures.
- It stifles future advancement.
- It increases reliance on foreign resources.
- It raises the government's obligation.

Primary Deficit: It is derived by subtracting interest payments from the fiscal deficit.

Primary deficit = Fiscal deficit – Interest payments on previous loans

Implications of Primary Deficit:

- It reflects how much of the government's borrowings will be used to cover costs other than interest payments.

Measures to correct different deficits:

- Government subsidy cuts will aid in reducing the deficit.

- Where assets are not being used efficiently, disinvestment should be carried out.
- Increased emphasis on tax-based revenues, as well as necessary steps to prevent tax evasion.
- Borrowing from both domestic and international sources.
- A broader tax base could also aid in the reduction of the government's deficit.

Fiscal Policy: Keynesian economics, a theory developed by economist John Maynard Keynes, serves as the foundation for fiscal policy. It is the system by which a government makes changes to its planned expenditure and tax rates in order to monitor and influence the performance of a country's economy. It is implemented in tandem with monetary policy, by which the central bank of the country impacts the country's money supply. This policy influence aids in containing inflation, increasing employment, and, most significantly, maintaining a healthy currency value.

Debt: A quantity of the money borrowed by one entity, the borrower, from another entity, the lenders, is referred to as debt. Governments borrow money to cover their deficits, which allows them to fund regular operations as well as large capital expenditures. This debt might be in the form of a loan or bond issuance.