# Chapter -2
## Unit-3
## THE PROCESS OF BUDGET MAKING

- A **budget** is a statement that presents the details of 'where the money comes from' and 'where the money goes to'.

- **The government budget** is a document presented for approval and legislation by a government and contains estimates of the proposed expenditure for a given period and the proposed means of financing them.

- In other words, a government budget is a schedule of the entire revenues and expenditures that the government expectsto receive and plans to spend during the following year.

- The budget includes projections forthe economy and its various sectors such as agriculture, industry, and services.



- The budgetalso contains estimates of the government's accounts for the next fiscal year called budgeted estimates.

- Being the document which consolidates revenues from all sources and outlays forall activities, the budget is the most comprehensive report of the government's finances.

Apart from the union budget, state and the local bodies have their own budgetary processes for the next financial year.

## The need or objective for budgeting

- Efficiently Allocate limited resources to ensure maximum social welfare.
- reallocate Resources in accordance with its declared priorities.
- Redistribution of income & wealth.
- Bring in stability, sustainable increase in real GDP & reduction in regional disparities.

## THE PROCESS OF BUDGET MAKING

**Budget is prepared by the Ministry of Finance**
**in consultation with**
**'NITI Aayog'**
**&**
**other relevant ministries.**

**Article 112 of the Constitution**

It provides that in respect of every financial year the 'president shall cause to be laid before both the houses of parliament a statement of the estimated receipts and expenditure of the government of India for that year, referred to as the "Annual Financial Statement".

The budgetary procedures are -

(i) Preparation of the budget
(ii) Presentation and enactment of the budget and
(iii) Execution of the budget.

The budget process mainly consists of two types of activities:

**Administrative**

wherein the Budget along with the accompanying documents are prepared in consultation with various stakeholders;

**Legislative**

wherein Budget is passed by the parliament after discussions.



## Step I
## Preparation

(August — January)

**Aug – Sept**

Budget Division
↓
issue circular to
all ministries, States, UTS etc
to
prepare their estimates
of
Receipts & Expenditures

**Oct – Nov**

Each Ministry share its
Budget estimates.
with
Budget Division

The expenditure Division of
Finance ministry
Demand
Estimated, Expenditures.

It includes

| Budget Estimates of Receipts & Expd. in respect of current & ensuring Financial year | Revised Estimates For the current year | Actual of the year. Preceding the current year. |
|---|---|---|



**Nov – Dec**

Pre-budget consultation Rounds

✓ A series of pre-budget consultations are done by
The union finance minister with-

- The finance ministers and chief ministers of states,
- various stakeholders and interest groups includingindustry associations,
- representatives from agriculture and social welfare sectors,
- labour organisations,
- experts from NITI Aayog,
- economists etc.

to elicit their suggestions on theproposed budget.

**Jan.**

Tentative Budget get approval from
council of ministers
&
Printing of Budget documents has started.

# Step II Presentation

(1 Feb — 31 March)

## 1 The Budget speech

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

### Budget speech is usually in 2 Parts



Part A of the budget speech gives an outline of the prevailing macro economic situation of the country and the budget estimates for the next financial year. Elaborating the priorities of the government, the minister presents a broad framework of the total funds raised by the government via taxes or borrowings, proposed government expenditure allocations for different sectors and fresh schemes for different sectors.

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

II The Budget documents available online as well as in Hardcopy.

- AFS (Annual Financial Statement)
  - Consolidated Fund of India + Contingency Fund of India + Public Account
- Demands for Grants
- Finance Bill
- Statements under FRBM Act
  - MARCO – ECONOMIC FRAMEWORK STATEMENT
  - MEDIUM TERM FISCAL POLICY CUM FISCAL POLICY STRATEGY STATEMENT



**Consolidated Fund of India**

All revenues received, loans raised and all moneys received by the government in repaymentof loans are credited to the Consolidated Fund of India and all expenditures of the government are incurred from this fund.

Money can be spent through this fund only if appropriated by the parliament. The consolidated Fund has further been divided into 'revenue' and 'capital' divisions.

**Contingency Fund of India**

A fund placed at the disposal of the President to enable him/her to make advances to the executive/Government to meet urgent unforeseen expenditure.

expenditure and does not require prior legislative approval, unlike with the Consolidated Fund.

For meeting such exigencies, advances are made to the executive from the contingency fund which is subsequently reported to the Parliament for recoupment from the Consolidated Fund of India.


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

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

**The expenditures of certain categories such as-**

- The emoluments and allowances of **the President of India** and his/her office, and
- emoluments of **Judges of supreme courts** and
- **high ranking personnel of constitutional bodies** across India



are 'charged' on the Consolidated Fund of India and are not subject to the vote of parliament, are also indicated separately in the budget.

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

**First**

first to secure a Vote on Account for a few months.

**Second**

Is followed by the AFS for that year or the full-fledged Budget.

**III**

Budget discussion — (Ist stage)
"General discussion
on
Fiscal policy issues only



standing committes
consider
Various Demands for Grants.
By Ministries.

↓

Adjourned
For a file
Period of time

(2nd State)

Voting in Lok Sabha
Accept or Refuse any Demand
(No voting for Grants in Rajya sabha)

outstanding Demand to the Vote of the House → **Guillotine**

## IV

After Discussion & Voting on Grants

↓

Govt. introduce "Appropriation Bill"

(Authority to Govt. to incur expd. from & ut of the ""consolidated fund of the India")

↓

**Cut Motion** ← Motion for Reduction
to
Various demand for grants
to
Reduce the sum sought by Govt.



## V

Presentation of "Finance Bill" to give
effect to govt's taxation proposal
in
Lok -sabha

this give effect to Financial proposals
of the govt. (TAX) for the Next
Financial year.

Finance Bill

Detailing of the

Imposition, Abolition, Alteration or Regulation
of
Taxes proposed in Budget

VI

After Passing the bills by Lok Sabha

Appropriation Bill

Finance Bill



We can say that "Budget Passed"

↓

it transmitted to Rajya Sabha
only for Recommendations.

↓

Rajya Sabha has to return it
within 14 days.

↓

Recommendations may be Accepted or Rejected
by Lok Sabha.

↓

Now it move to "President".

↓

one the President gives Assent, Budget is
considered as Final.
&
Published in Official Gazette of India.

## Step III
## Execution

(1 April — 31 March)

Parliament has to pass
Finance bill within
75 days of its
introduction.

From Year 2017-18
Railway Budget
Merged with
General Budget.

## Types of Budget

- **Balanced Budget**
  - R = E
- **Unbalanced Budget**
  - **Surplus**
    - R > E
  - **Deficit**
    - R < E

I

## Sources of Revenue

Ministry of Finance

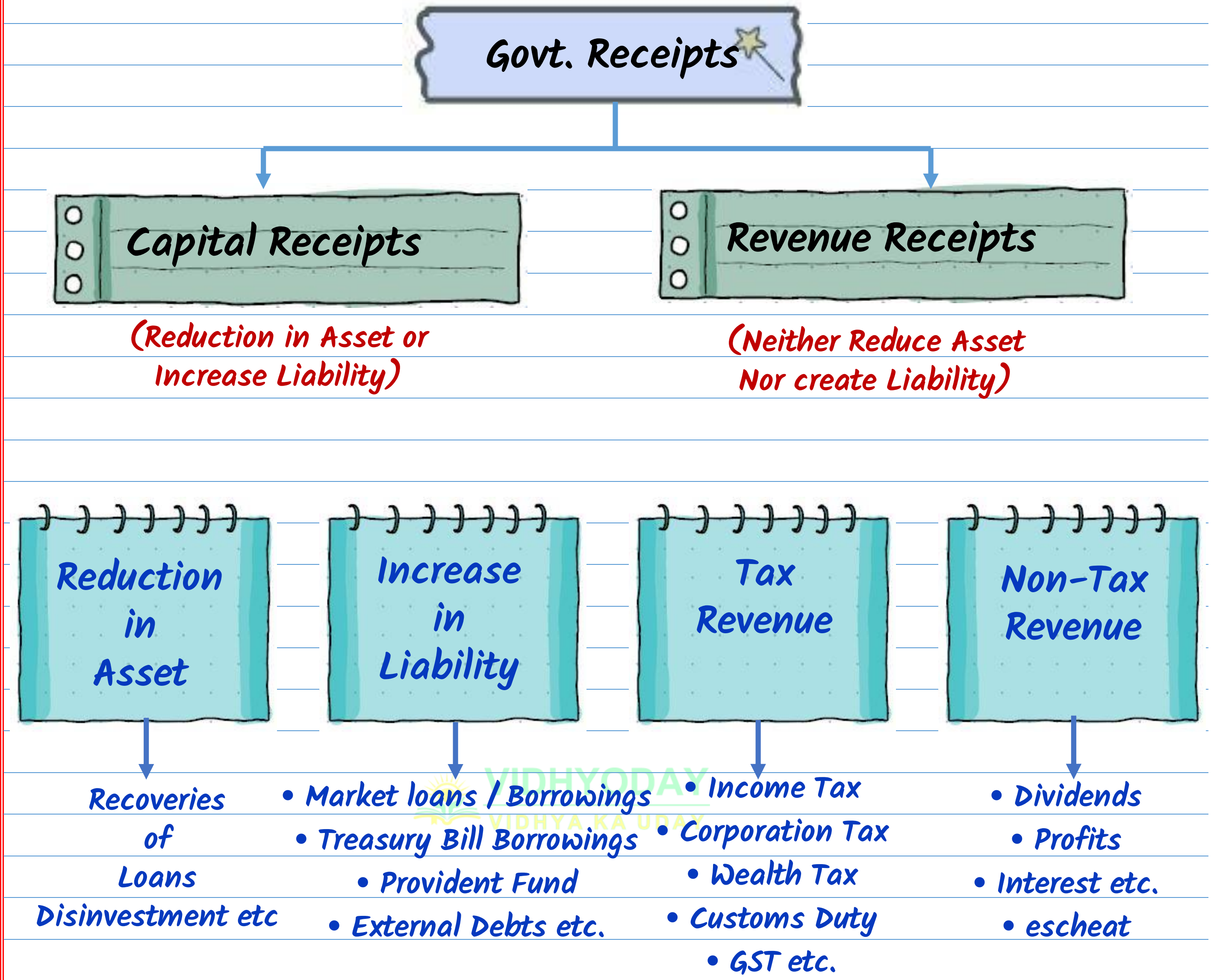
↓

Department of Revenue

↓

Two statutory Bodies.

- **CBDT**
  - Central Board of Direct Taxes
  - ⇩
  - Levy & collection of all Direct Taxes
- **CBIC**
  - Central Board of Indirect Taxes & Custom
  - ⇩
  - Levy & collection of GST, Customs & other indirect taxes




<u>Government receipts are classified under two categories:</u>

1 **Revenue receipts** which consists of **tax revenue and non tax revenue.**

2 **Capital receipts** which consists of **debt receipts and non debt capital** receipts.

<u>The broad sources of revenue are:</u>

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

**Non-tax revenues comprise the following:**

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

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

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

**Capital Receipts include:**

1. **Non debt capital receipts which include**
   - (a) **Recoveries of loans and advances** -by the government to PSEs, state governments, foreign governments and union territories
   - (b) **Miscellaneous capital receipts (disinvestments and others)**- sale proceeds of government assets, including those realized from divestment of government equity in public sector undertakings (PSUs).
2. **Debt capital receipts which include**
   - (a) **Market loans** for different purposes by the government, borrowing from the Reserve Bank of India and loans takenfrom foreign governments/institutions.
   - (b) **Short term /Treasury bill** borrowings by the government,
   - (c) **Securities issued against small savings,**
   - (d) **State provident fund (Net)**
   - (e) **Net external debts**
   - (f) **Other receipts (Net)** include Sovereign Gold Bond Scheme, receipts from international financial institutions and saving bonds.



## II Public Expenditure Management

**Public expenditure management is the process that allows governments tobe fiscally responsible.** Public expenditure programmes or projects should be designed and implemented to provide given levels of outputs or achieve specific objectives at

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

- Larger Deficits
- High Tax
- Lower Growth
- Greater Debt Burden
- Fewer Resources were Available for Alternate use

## The Department of Expenditure of the Ministry of Finance

✓ It is the nodal department for overseeing the public financial management system in the central government and matters connected with state finances.

✓ It is responsible for-

- implementation of recommendations of the Finance Commission & Central Pay Commission,
- monitoring of audit comments/ observations
- preparation of central govt. Accounts.
- assists central Ministries/ Departments in
  - Controlling the costs & prices of public services
  - Reviewing systems & procedures to optimize outcomes

IMP — CAR

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

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

✓ One of the explanatory documents of the budget document is the 'Expenditure Profile' (earlier known as expenditure budget) consisting of relevant data across all ministries/departments to outline a profile of the general financial performance of the government of India.

✓ It givesan aggregation of various types of expenditure and certain other items across demands.

✓ The total expenditure through budget (both current and capital) of various ministries and departments is composed of central expenditure and transfers.

**Govt. Expenditure**

**Capital Expenditure**
(Reduction in Liability or creation of Asset)

**Revenue Expenditure**
(Neither Reduce Liability Nor create Asset

**Reduction in Liability**
- Repayment of Borrowings

**Creation of Asset**
- Acq. of Land, Buidling
- Purchase of P & M
- Investment
- Loans & Advances

**Expd. for Normal Functioning Like**
- Interest Payment
- Grants given to states
- Salaries to Govt. employees etc.

In Expenditure budget, the Central government expenditure is classified into six broad categories as below:

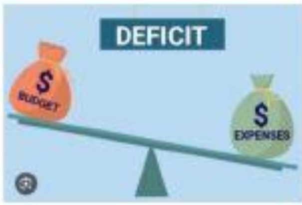
- **Centre's Expenditure**
  - Establishment Expd.
  - Central sector schemes eg: Namami Gange, PMEGP, Khelo India.
  - On CPSEs & autonomoys Bodies eg: Indian Institute of Agri Research, ICAI etc.
- **Centre's Sponsored**
  - Centrally sponsored scheme → eg: PMAY, SBM, PMGSY
  - Finance Commission Transfer
  - Transfer to State



✓ Establishment expenditure includes establishment-related expenditure of the ministries/ departments, and attached and subordinates offices.

✓ Central Sector Schemes (CS) include those schemes which are entirely funded and implemented by the central agencies under union government ministries/departments.

# Budget Deficit




✓ When a government spends more than it collects by way of revenue, it incurs a budget deficit.

✓ There are various measures that capture government deficit and they have their own implications for the economy.

**Budget Deficit** | **Revenue Deficit** | **Fiscal Deficit** | **Primary Deficit**

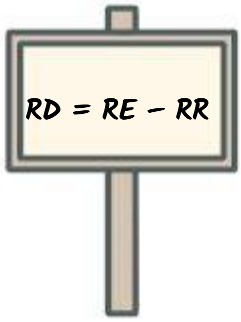


## Budget Deficit

**BD = TE – TR**

✓ Budgetary Deficit is defined as the excess of total estimated expenditure over total estimated revenue is the difference between all receipts and expenditure, both revenue and capital.

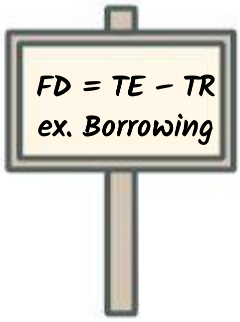
## Revenue Deficit




- ✓ The revenue deficit refers to the excess of government's revenue expenditure over revenue receipts. It shows the shortfall of government's current receipts over current expenditure.
- ✓ It shows the government revenue is insufficient to meet the regular expenditures in connection with the normal functioning of the government, or the government is diverting resources from other sectors to finance its current expenditure.

**Revenue deficit = Revenue expenditure – Revenue receipts**

## Fiscal Deficit




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

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

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

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

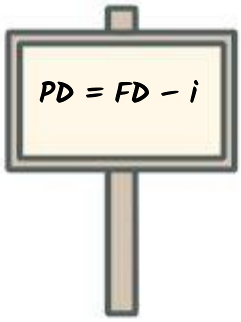
**Fiscal deficit = Total Expenditure –Total Receipts excluding borrowing**

OR

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

- ✓ *The fiscal deficit will have to be financed by borrowing. Therefore fiscal deficit points to the total borrowing requirements of the government from all sources.*
- ✓ *In case revenue deficit occupies a substantial share of fiscal deficit, it is an indication that a large part of borrowingis used for consumption purposes rather than for investment.*

## Primary Deficit




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



- ✓ *In other words whereas fiscal deficit indicates borrowing requirement inclusive of interest payment, primary deficit indicates borrowing requirement exclusive of interest payment.*
- ✓ *It tells how much of the government's borrowings are going towards meeting expenses other than interest payments.*
- ✓ *Primary deficit thus gives an estimate of borrowingson account of current expenditure exceeding current revenues.*
- ✓ *The goal of measuring primary deficit is to focus on present fiscal imbalances.*

**Primary deficit = Fiscal deficit – Net Interest liabilities**

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

# Public Debt

- ✓ Government debt from internal and external sources contracted in the Consolidated Fund of India is defined as Public Debt.
- ✓ The government raises funds primarily from thedomestic market using market-based and fixed-rate instruments to finance its fiscal deficit.
- ✓ Public debt, means debt incurred by the government in mobilizing savingsof the people in the form of loans, which are to be repaid at a future date with interest.
- ✓ Public debt is not a one-time exercise of borrowing and repaying.
- ✓ Debt servicing is a continuous exercise as a portion of debt falls due each month, government does not usually cut expenditure or raise taxes to provide funds to retire or repay the maturing bonds.
- ✓ Rather, the government simply refinances the debt, i.e. it sells new bonds and uses the proceeds to pay off holders of the maturity bonds.
- ✓ Hence public debt management becomes a crucial task or responsibility of the government and plays an important role in macroeconomic stability of a country.
- ✓ Productive use of public debt contributes to economic growth and welfare of the society.

# Public Debt Management

It refers to the task of determining, by the fiscal and monetary authorities, the size and composition of debt, the maturity pattern, interest rates, redemption of debt etc.

It is the process of setting up and implementing the strategy for managing public debt in order to raise the required amount of funding at the desired risk and cost levels.

**The overall objective of the central government's debt management policy**

It is to "meet the central government's financing needs at the lowest possible long term borrowing costs and also to keep the total debt within sustainable levels.

Additionally, it aims at supporting development of a well-functioning and vibrant domestic bond market".



> Keeping in view the increasing magnitude of public borrowing both internal and external, the extent to which the government can mobilise funds from public depends upon the skilful public debt management.

# Debt Management Strategy

**It is based on three broad pillars namely**

- Low Cost of borrowing
- Risk Mitigation
- Market Development

## Institutions responsibles For Public Debt Management

**RBI**
Domestic Marketable debt eg: dated securities, treasury bills

**Ministry of Finance (MOF)**
External Debts

**MOF, Budget Division & RBI**
other Liabilities such as small savings, deposit, reserves etc.



## Responsibility of Managing the Domestic Debt

**IDMD**

Internal Debt Management Department of Reserve Bank of India

↓

Act as a Debt Manager for internal debt

- Treasury bill issued to meet short term cash requirements of the Govt.
- Debted securities issued to mobilise longer term resources to Finance Fiscal Deficit

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

## External debts (bilateral & Multilateral) Loans

✓ It is managed by the Department of Economic Affairs in the Ministry of Finance (MoF). Most of the external debt is sourced from multilateral agencies (International Bank for Reconstruction and Development, Asian Development Bank, etc.).

✓ There is no sovereign borrowing from international capital markets. The entire external debt, in terms of original maturity, is on long -term basis and a major part is at fixed interest rates.

## The Fiscal Responsibility & Budget Management

**FRBM**

It was passed in 2003 to provide a legislative framework for reduction of deficit and thereby debt of the central government to a sustainable level.

**The objectives of the act are:**

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

## The Public Debt Management Cell

**PDMC**

✓ This was created in 2016 under the Department of Economic Affairs.

✓ The Medium Term Debt Management Strategy or MTDS 2021-24 is a framework to determine the appropriate composition of the debt portfolio.

✓ The objective of the debt management strategy is to efficiently raise debt at the lowest possible cost in the medium term while ensuring that financing requirements are met without disruption.

## RBI Retail Direct

***As part of continuing efforts to increase retail participation in G-sec, 'RBI Retail Direct' facility was announced on February 5, 2021:***

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

## Some other Terminology of Budget

### Outcome Budget

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



✓ *The outcome budget is a progress card on what various ministries and departments have donewith the outlays in the previous annual budget.*

✓ *It measures the development outcomes of all government programs and whether the money has been spent for the purpose it was sanctioned including the outcome of the fund usage.*