WHITEOAK LEARNING EDGE

WHITEOAK CAPITAL MANAGEMENT

THE ART AND SCIENCE OF INVESTING

CONCEPTOPEDIA

"Decoding Union Budget Concepts"

Union Budget is one of the most anticipated financial event, which is closely tracked. As much as we give importance to its announcements and key highlights, it is equally pertinent to understand the underlying terminologies.

In this Conceptopedia note we will look at the following concepts:

- **Meaning of Union Budget & Economic Survey**
- **Understanding Union Budget and Fiscal Deficit taking the analogy of a common man**
- **Receipts and its components – Tax Revenue, Non-Tax Revenue, Non-Debt Capital Receipts and Debt Capital Receipts**
- **Glossary – Various types of Taxes**
- **Expenditures and its components – Revenue Expenditure and Capital Expenditure**
- **Fiscal Deficit, Revenue Deficit, Effective Revenue Deficit and Primary Deficit**
- **Sources for financing Fiscal Deficit**
- **Is Fiscal Deficit good or bad for the economy? – Arguments 'for' and 'against' having a Fiscal Deficit**
- **Measures to manage Fiscal Deficit**

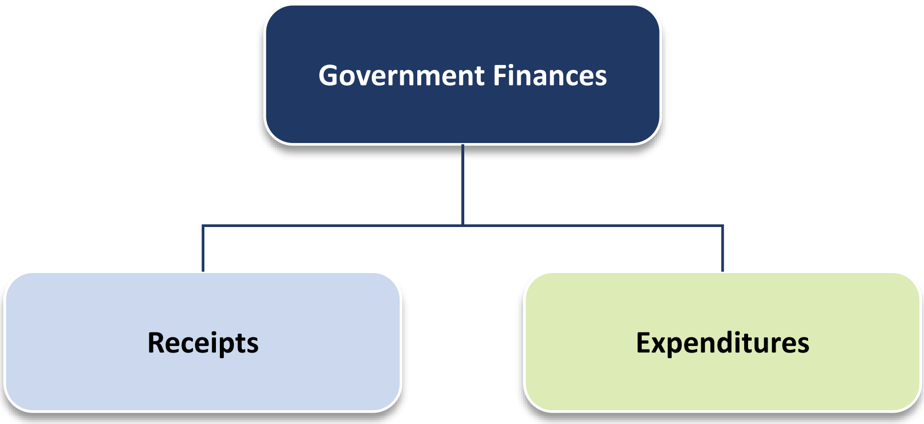
As the Government is elected by the people and for the people, its responsibility is to understand and fulfil the impending demands of its citizens.

It thus fulfills many important roles and duties for the overall development of the country.

Various roles and responsibilities of the Government

1. Providing employment opportunities and reducing income inequality
2. Developing infrastructure by building roads, highways, bridges etc.
3. Boosting economic growth
4. Enhancing education, skills & literacy levels by building colleges, schools and training institutes
5. Improving health care services and its access to all strata of society
6. Maintaining law & order and protecting its civilians
7. Helping the social sector by giving access to affordable houses and food-grains at subsidized rates etc.

The Government needs necessary funds and adequate resources also known as **"receipts"**, so as to deploy the same for meeting various types of **"expenditures"** in order to effectively discharge its duties and attain various macro-economic and social objectives.



Examples of Receipts:

- Taxes – Direct Taxes & Indirect Taxes
- Dividends received from Public Sector Enterprises
- Interest receipts
- Disinvestments
- Telecom spectrum receipts etc.

Examples of Expenditures:

- Salaries & Pensions to Government Employees
- Food, Fertilizer and Fuel Subsidies
- Grants or Funds allocated to States
- Infrastructure projects
- Social welfare programs – like Drinking Water Mission, MGNREGS etc.
- Paying interest on debt borrowed by Government etc.

Just as a common man has major and ancillary sources of income like salary, professional fees, dividends, interests, capital gains etc. and also incurs various types of expenses like paying utility bills, transportation expenses, schools fees, EMIs etc.

Similarly the Government also has various sources of income like tax revenues, dividend income, interest income, proceeds from disinvestments etc. and also incurs expenses like paying salaries, spending for infrastructure projects, buying defence equipments, supporting social welfare programs etc.

Common Man's Income Statement	
Receipt	**Expenditure**
Salary	Paying EMIs
Dividends from Stocks, Mutual Funds	Buying furniture, kitchen appliances etc.
Interest income from Fixed Deposits	Buying groceries
Rental Income	Paying utility bills
Proceeds from Real estate, Equity, Fixed Income asset classes etc.	School fees
	Transportation expenses

Government's Income Statement	
Receipt	**Expenditure**
Tax receipts	Salaries
Dividends	Pensions
Interest income	Tax Adminstration
Asset Sale - Disinvestment, Proceeds from Coal block auctions and Spectrum receipts etc.	Grants and Tax transfers to States
Loan recovery amounts	Welfare Schemes
	Infrastructure Projects

Understanding Fiscal Policy and Union Budget

Assume a person earns INR 1 lac a month but he also incurs expenditures of INR 1.5 lacs a month. As his expenditures are more than his income, to bridge the gap he may borrow from money from a bank, or from his friends and family members or redeem some of his investments.

Similarly, when the expenditures of the government are more than the receipts, it's called **"Fiscal Deficit"** and to fund the deficit, the government borrows money by issuing government securities, financing its deficit from National Small Savings Fund, borrowing from International Money Fund (IMF) and from foreign governments etc.

Government's Financial Management is thus called **"Fiscal Policy".** Fiscal policy involves the **government's use of spending and taxation** to meet its **macroeconomic goals.**

Union Budget is the **statement of estimated receipts and expenditures of the government**. It is also referred to as the **"Annual Financial Statement"**, according to Article 112 of the Indian Constitution.

Difference between Union Budget and Economic Survey

Economic Survey	Union Budget
Since 1964, the Economic Survey is presented a day before the Budget.	The Union Budget is presented a day after the Economic Survey is presented.
The Economic Survey gives the report and data regarding the developments of the economy of India in the last 12 months. It throws light on the government policy initiatives and the performance of major development programs and shares economic projections in the short and medium-term.	The Union Budget is a detailed financial plan by the Central Government which contains the data about the expenditures and receipts for a particular financial year (April 1st - March 31st).
The Department of Economic Affairs under the Ministry of Finance is responsible for presenting the economic survey. This report is submitted to both the houses of parliament (Lok Sabha and Rajya Sabha). Its recommendations ~~are~~ not binding on the Government.	Proposals made in the Union Budget, if passed by Parliament (Lok Sabha), takes effect from April 1st of every year and are valid till March 31st of the next year.

Did You Know?

Bougette(buh.**get**)[1]

Bahikhata(**बहीखाता**)[3]

Budget[2]

Digital Bahikhata (**बहीखाता**)[4]

In 1760, the Chancellor of the Exchequer in England would carry statement of Government finances to the House of Commons in a **leather bag.**

The French word for such a leather bag is **"Bougette"** which became **"Budget"** in English.

Currently to give it a national flavor, the budget statements are also called **"Bahikhata"** and lately with the digital drive & adoption trends, the budget statements and the announcements are presented by the finance minister using an **iPAD** and are also available paperless using the **"Union Budget Mobile App".**

Image Source: [1,3] www.timesofindia.indiatimes.com; [2] www.goodreturns.in; [4] www.fortuneindia.com

Three components of Government's Annual Financial Statement

Receipts

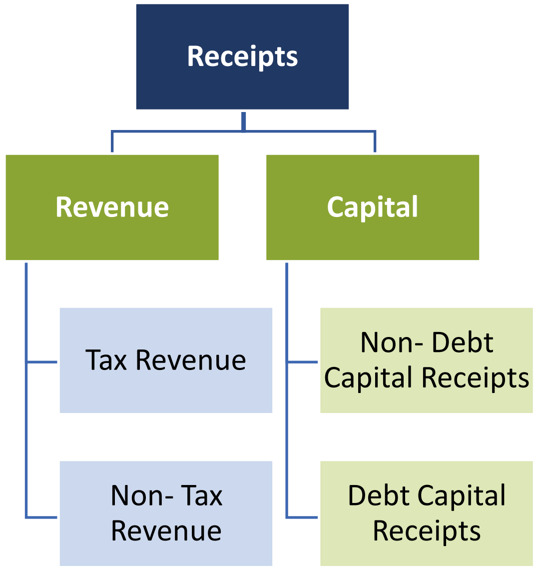
Expenditures

Deficits

Components	FY-24 (BE) (INR Crores)
Tax Revenue (Net)	23,30,631
Non Tax Revenue	3,01,650
Non-Debt Capital Receipts (Disinvestments & Others)	84,000
Total Receipts (1)	**27,16,281**
Revenue Expenditure	35,02,136
Capital Expenditure	10,00,961
Total Expenditure (2)	**45,03,097**
Fiscal Deficit (as expend > receipts; 2-1) (3)	**17,86,816**
Nominal GDP estimates for 2023-2024 **(4)**	30,175,065
Fiscal Deficit as a % of GDP (3/4)	**5.9%**

BE - Budgeted Estimates

Breaking down Government Receipts



INR. in crores	FY-24 (BE)
Tax Revenue (Net)	23,30,631
Non Tax Revenue	3,01,650
Non-Debt Capital Receipts (Disinvestments & Others)	84000
Total Receipts (1)	**27,16,281**

- **Receipts** – It presents the information on how much the Government intends to collect as its financial resources for meeting its expenditure requirements. It is further bifurcated as **Revenue Receipts and Capital Receipts.**

- **Revenue Receipts** – They are recurring and routine in nature, and the government receives them in the normal course of activities. They don't affect the asset-liability position of the government. They are further broken down into **Tax and Non-Tax revenues. Examples of Tax Revenues**:- **Income Tax, Corporate Tax, Customs Duties, Union Excise Duties, and GST. Examples of Non-Tax Revenues: Interest receipts, Fees/ User Charges like National Highways & Bridges usage/toll fees etc., Dividends from PSUs and Telecom Spectrum Receipts etc.**

- **Capital Receipts** - They lead to either a reduction in the assets or an increase in the liabilities of the Government. **Capital Receipts that lead to a 'reduction in assets'** are Recoveries of Loans by the Government and earnings from **Disinvestments**; **Capital Receipts that lead to an 'increase in liabilities'** are Debt or Government Borrowings to fund Fiscal Deficit.

- **FY-24:- Estimated Net Tax Revenue is INR 23.306 lac crores.** "Net" means the Tax revenue which the centre keeps after giving away the state's share of tax revenue. **Non-Tax Revenue is estimated to be INR 3.016 lac crs.** Excluding the fund inflows from government borrowings as it is a liability or debt for the government, the **Non-Debt Capital Receipts are estimated to be INR. 84k crs. Therefore, the Total Receipts:- INR 23.306 lac crs + INR 3.016 lac crs + INR 84k crs = Rs. 27.162 lac crs.**

Source: Budget Documents

Glossary - Various Types of Taxes

I. **Tax Revenue:-** It is the amount of money collected by the government from taxes on income, profits, and the consumption of goods and services. This includes both direct and indirect taxes.

II. **Direct Tax:-** It is the tax imposed on the income of individuals and businesses. Examples:- Income tax and Corporate tax.

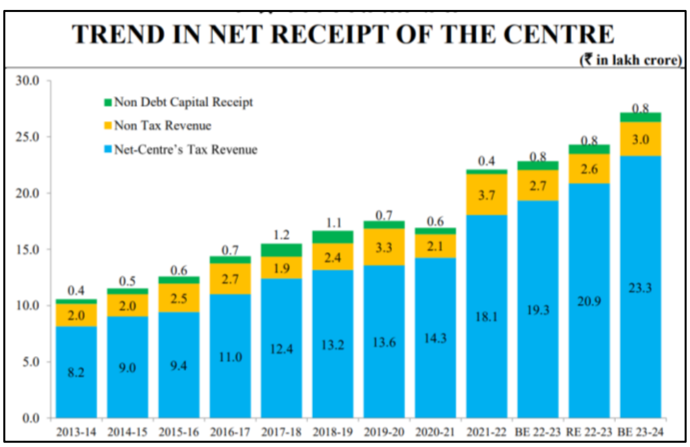
III. **Indirect Tax:-** It is the tax imposed on goods and services. Examples: Customs duty, Union Excise duty and Goods and Service Tax (GST).

IV. **Customs Duty**:- It is a type of indirect tax imposed on the import and export of goods in or out of a country. The cost of this tax is typically passed on to the end consumer of the goods.

V. **Union Excise Duty:-** It is a type of indirect tax levied on those goods, which are manufactured in the country and are meant for domestic consumption. It is a tax on manufacturing, which is paid by the manufacturer, but he passes this burden on to the consumers.

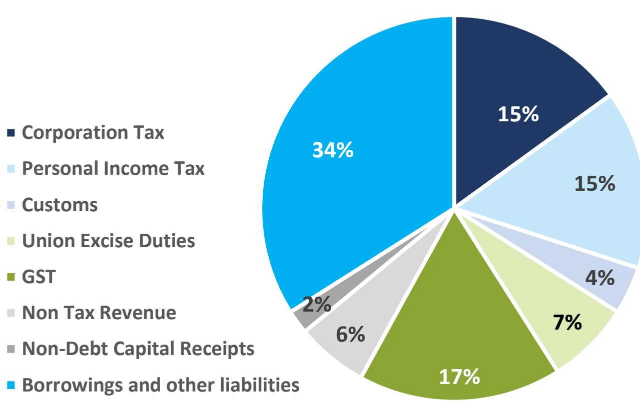
VI. **Goods and Service Tax:-** It is an indirect tax imposed on the supply of goods and services.

Source: ndtv.com, financial express



Source: Budget Documents
BE – Budgeted Estimates
RE – Revised Estimates

Share of Government Receipts



Total receipts are inclusive of States' share of taxes and duties. Figures have been rounded off

- As can be seen from the charts the biggest contributor of income to the government's kitty is **Tax Revenue** and within that **Corporation Tax, Personal Income Tax and Goods and Services Tax (GST) are the major contributors.**

- Though government borrowings and other liabilities are part of Receipts, they are a liability to the centre and are undertaken to fund fiscal deficit. For example, Fiscal Deficit estimated for FY-23' is **INR 17.86 lac crs** and the government borrowing & other liabilities also reflect the same amount.

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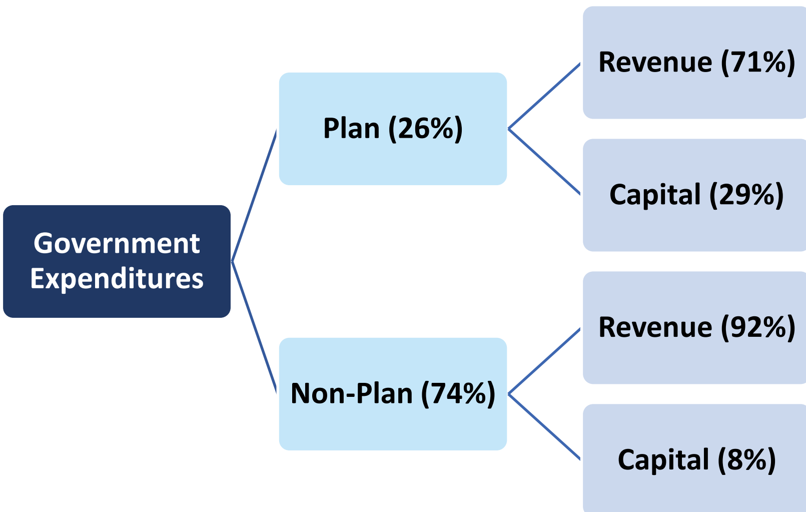
Earlier Break-up of Expenditures

Example:- Government Expenditure break up (FY-17)



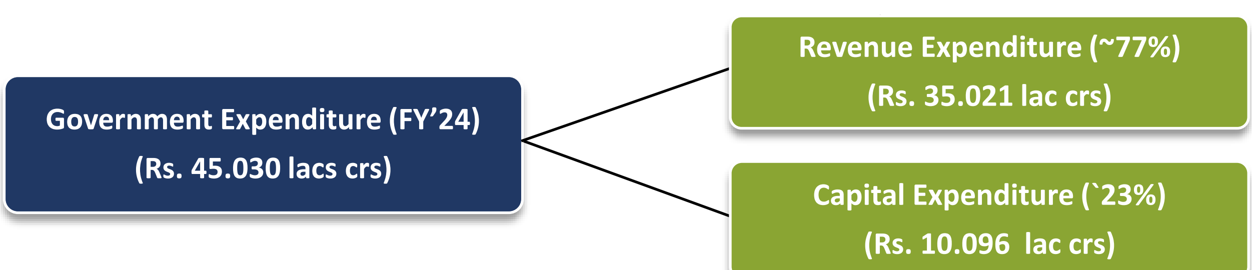
Earlier Government Expenditures were first bifurcated as Plan and Non-Plan Expenditures and then further divided into Revenue and Capital Expenditures.

Plan expenditures referred to government expenditures, which is meant for financing the programs formulated under the ongoing/ previous five-year plan.

Non-Plan expenditures referred to expenditures which are not included under the Plan Expenditures such as subsidies, interest payments etc.

However, from FY- 18 onwards, the Government Expenditure components have been streamlined and **Plan and Non-Plan expenditure classification has been done away with.**

Government Expenditures is now divided into **“Revenue Expenditure” and “Capital Expenditure”.**



Source: Budget Documents

Expenditure

Revenue

Revenue expenditures are expenditures incurred for aspects like the normal functioning of various government departments, grants given to state governments and interest payments made on the debt (government securities issued) by the Union Government etc.

Examples:

- **Interest payments for the amount borrowed by Government**
- **Salaries, Pensions**
- **Subsidies – Food, Fuel, Fertilizer**
- **Grants made to states**
- **Welfare schemes – MNREGS, PM Kisan**
- **Education services**
- **Health protection scheme – Ayushman Bharat**
- **Skill India**
- **PM Poshan** *(nutritional status of girls and women)*

Capital

Capital expenditures or Capex refers to expenditures incurred by the government towards acquiring, upgrading, repairing and building assets and infrastructure like roads, bridges, highways, airports and spending on defense equipments, optical fibre cable-based network for defense services etc.

Examples:

- **Expenditure on purchase of land, buildings, machinery**
- **Power projects**
- **Road & Highways**
- **Infrastructure**
- **Defence**
- **Metro Rail**
- **Railways**
- **Housing**
- **Jal Jeevan Mission**

Composition of Expenditure

(% share of total expenditure)

Source: Budget Documents

Interest payments which is servicing of interest amount by the central government on account of issuing government securities constitute a major share of expenditures i.e. ~24% of total expenditure (FY’24:- INR 10.79 lac crs out of INR 45.03 lac crs).

Analogy - A common man's expenditures

When drawing a household budget, we begin by identifying our goals where we propose to spend and save for future expenses – **regular & ongoing expense-, short-, medium- & long-term goals.**

Type of expenses and linking it to revenue and capital expenditures:

- Maintenance Expense – upkeep, essentials **- Revenue expenditure**
- Personal Loan EMIs **- Revenue expenditure**
- Vacation **- Revenue expenditure**
- Education **- Productive Revenue expenditure**
- Gym membership/ yoga classes **- Productive Revenue expenditure**
- Health and Nutritional Supplements **- Productive Revenue expenditure**
- House (long term) **- Productive Capital expenditure**
- Vehicle, jewelry **- Capital expenditure (depreciating)**
- Emergencies **- Unplanned Revenue expenditure**

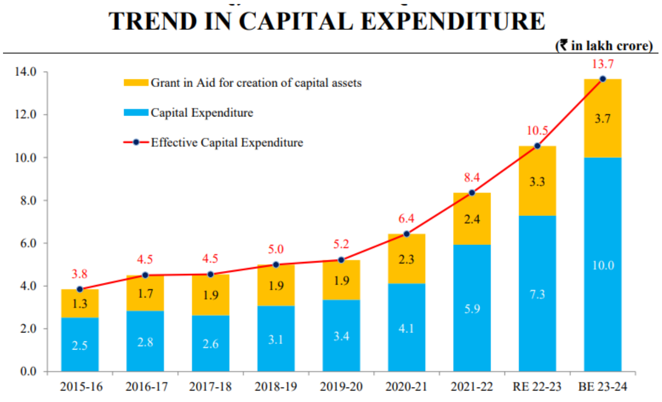
Though there are certain expenses in a common man's life which are unavoidable, however the endeavor should be to enhance savings and judiciously spend the hard-earned money on areas which will provide maximum long-term and sustainable benefits.

Not all expenditures lead to creation of tangible assets such as apartments and business complex, however what matters most is the productivity derived out from a particular type of expenditure.

Similarly for a government too, it's **focus should be to tap the leakages in expenses say by reducing corruption in the supply chain, bringing better accountability and spending on productive areas.**

Initiatives like Skill India, Vaccination drive though don't count as Capex, but are important for being employable, enhancing immunity levels and well being.

Capital expenditures (Capex) create **assets that are long-term in nature and allow the economy to generate revenue for many years.** It offers employment opportunities and aids economic growth.



Capex has witnessed steady increase for the years.

'Grants-in-aid' refers to grant given by the Central Government to the state governments, constitutional authorities, autonomous bodies for creation of capital assets.

Effective Capital Expenditure = Capex + Grant in Aid for creation of capital assets.

Source: Budget Documents

Components	FY-24 (BE) INR in crores
1. Revenue Receipts	**26,32,281**
2. Tax Revenue (Net)	23,30,631
3. Non Tax Revenue	3,01,650
4. Capital Receipts	**18,70,816**
5. Non-Debt Capital Receipts (Disinvestments & Others)	84,000
6. Borrowings and other liabilities	17,86,816
7. Total Receipts (1+4)	**45,03,097**
8. **Revenue Expenditure** of which	35,02,136
9. Interest Payments	10,79,971
10. Grants in Aid for creation of capital assets	3,69,988
11. **Capital Expenditure**	10,00,961
12. Total Expenditure (8+11)	**45,03,097**
13. Effective Capital Expenditure (10+11)	**13,70,949**
14. Revenue Deficit (8-1)	**8,69,855**
15. Effective Revenue Deficit (14 -10)	**4,99,867**
16. Fiscal Deficit (12-(1+5))	**17,86,816**
17. Primary Deficit (16-9)	**7,06,845**

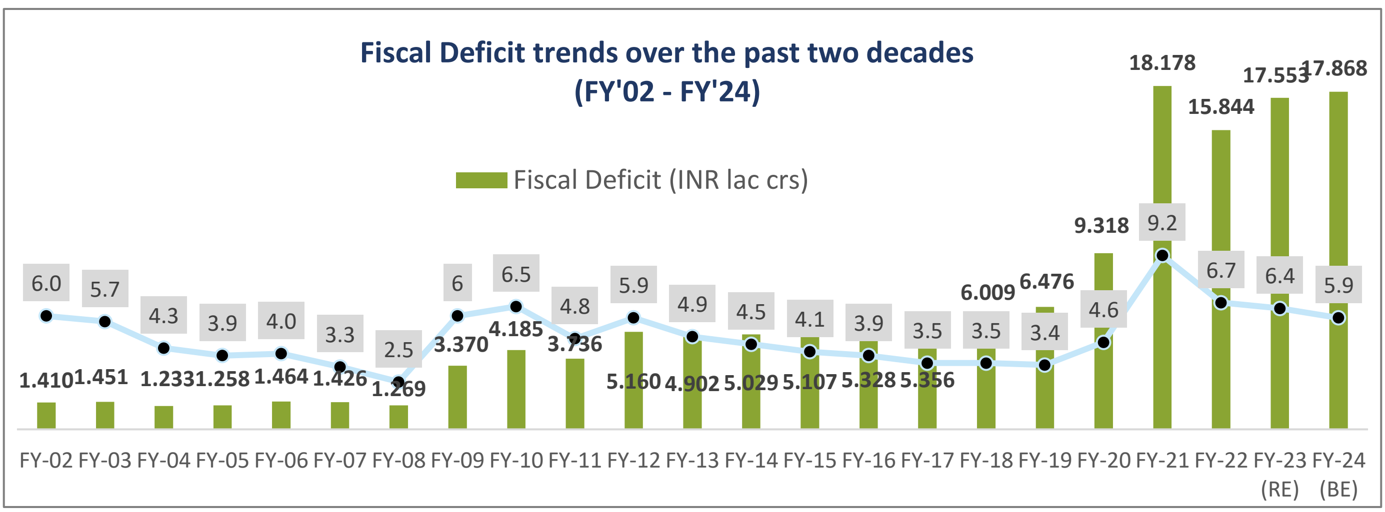
Deficits - Glossary

Fiscal Deficit: Fiscal deficit happens when the 'government's spending' exceeds its 'receipts' (non-borrowed income) during the fiscal year. This indicates the total amount of borrowing needed by the government.

Revenue Deficit: It refers to the difference between 'revenue expenditure' (expenditures pertaining to the government's day-to-day operations) and 'revenue receipts' (income from taxes and other sources). It is an important measure of the government's financial health.

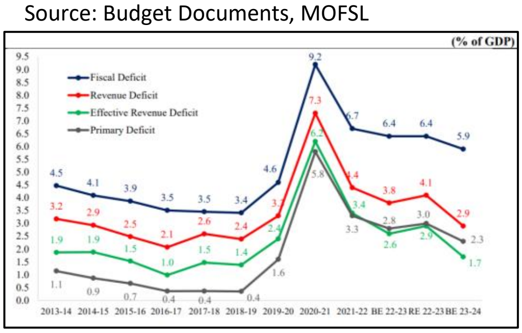
Effective Revenue Deficit: It is the difference between 'revenue deficit' and 'grants in aid for the creation of capital assets'. The central government gives grants to state governments and union territories every year. With the help of these grants, they create capital assets. However, these are not added to the capital expenditures of the central government. Therefore, 'effective revenue deficit' has been introduced in 2013, which removes such type of grants to give a true picture of the revenue expenditure.

Primary Deficit: It is the difference between 'fiscal deficit' and 'interest payments'. Since interest payments form a significant part of government expenditures, excluding it gives an idea of what are the other expenditures contributing to deficit.



Source: Budget Documents, MOFSL

RE: Revised estimates, BE: Budgeted estimates



Source: Budget Documents

From the pandemic levels when the fiscal deficit touched an all time high of 9.2% levels in FY-21' on account government stimulus measures (atmanirbhar package) and low GDP growth, fiscal deficit is expected to reduce to 5.9% of GDP in FY-24' BE.

Government's endeavor is to keep deficits in check as excessive deficits can be detrimental to economic growth and stability.

Sources of financing of Fiscal Deficit

Components	FY-24 BE in crores	% of Total Borrowings
1. Debt Receipts (Net)	**1798603**	
2. Market Borrowings (G-sec + T-bills)	1230911	69%
3. Securities against Small Savings	471317	26%
4. State Provident Funds	20000	1%
5. Other receipts (Internal Debt and Public Account)	54258	3%
6. External Debt	22118	1%
7. Drawdown of Cash Balance	**-11787**	
Grand Total (1+7)	**1786816**	

- ***~69% - 70% of Fiscal Deficit is financed by Market Borrowings which is issuance of Government Securities & T-bills.***
- ***~ 26% is financed through Securities against Small Savings.***
- ***Government's reliance on borrowings from external sources like International Monetary Fund (IMF) and other foreign governments is much lower.***

- Net Debt Receipts:- Borrowings after adjusting securities that have matured or pre-paid by the government.
- Market Borrowings:- Issuance of government securities called G-secs and Treasury Bills.
- Securities against Small Savings:- National Small Savings Fund (NSSF) combines the collections obtained from different small saving schemes like PPF, NSC, Post Office Savings Account etc.. The money parked in the NSSF is used by the centre and states to finance their fiscal deficit, while the balance is invested in central and state government securities.
- State Provident Funds:- As State Provident Funds are government-managed retirement savings scheme, centre can also finance fiscal deficit using this avenue.
- Other receipts:- It comprises borrowings from special deposits, reserve funds etc.
- External Debt:- Borrowing from external sources like the IMF and other foreign governments.
- Drawdown of cash balances:- It refers to withdrawing funds from the cash balances that the government maintains with RBI (Reserve Bank of India), as the RBI is the banker for the Government of India.

Source: Budget Documents

Is Fiscal Deficit – Good or Bad for the economy?

Arguments against the size of Fiscal Deficit

- It may lead to a **debt trap.**
- It may lead to **unnecessary and wasteful expenditures** by the government.
- If markets lose confidence in the government, investors may not be willing to refinance debt. If the debt is in foreign currency, this can lead to the **government defaulting on its debt and there is risk of rating downgrades.** The government may resort to **excessive printing of new currency.** It may cause the **currency to devalue and lead to hyper-inflation (uncontrolled inflation & low GDP growth).**
- Increased government borrowing to finance fiscal deficit tends to **increase interest rates.** As a result, corporates may reduce their borrowing and investment spending. This is referred to as "**Crowding Out Effect"** because government borrowing is taking the place of private borrowing.
- Higher deficits leads to higher future taxes which **disincentivizes entrepreneurship.** This leads to **lower long term economic growth.**

Arguments for the size of Fiscal Deficit

- If the debt is being primarily held **by domestic citizens**, the scale of problem is overstated.
- When the borrowing is for **productive causes**, and there is a **fine balance between social good and economic good**, future economic gains will be sufficient to repay the debt.
- When the government has a **roadmap to reduce deficit**, and when **private investment picks up**.
- Fiscal deficits may **prompt tax reforms**.
- If economy is **operating at less than full capacity**, deficits don't divert capital away from productive uses. On the contrary, deficits can **aid in increasing GDP and employment.**
- **Ricardian Equivalence**:- As a proactive measure, firms and taxpayers may usually increase their savings in anticipation of higher future taxes. Due to increased savings, government can comfortably finance fiscal deficit by issuing government securities.

The fiscal deficit is a positive outcome if it leads to the creation of assets. However, it is detrimental to the economic condition of a nation if it is used to simply cover revenue deficit.

Measures to manage fiscal deficit

- Increased emphasis on tax-based revenues, better tax administration, resolving tax disputes, broader tax base, appropriate measures to reduce tax evasion and increased tax compliance. This helps in increasing tax revenues and decreasing fiscal deficit.
- Disinvestments should be done where assets are not being used effectively.
- Financial inclusion initiatives leads to formalized economy and aids in economic growth and tax revenues. Example:- Pradhan Mantri Jan Dhan Yojna (PMJDY).
- Reduction in subsidies leakages by facilitating Direct Benefit Transfers (DBTs) to lower income households and other beneficiaries leads to better traceability & accountability of fund transfers and helps in reducing fiscal deficit. Example:- JAM Trinity Architecture (Jan Dhan Yojana bank account-Aadhaar- Mobile).
- Avoiding unplanned expenditures.
- Increasing capital expenditures.
- Prudent borrowing from domestic sources and a clear roadmap to reduce fiscal deficit. Example:- Fiscal Responsibility and Budget Management Act (FRBM Act) and Fiscal Council.
- Lesser borrowing dependency from external sources.
- Reforms and better policy initiatives like Production Linked Incentives (PLI), GST etc. helps in improving economic growth and increasing tax revenues
- Reducing off-balance sheet funding or window dressing. Off-balance sheet funding refers to indirect borrowings through PSUs, for example:- issuing ‘special bonds’ by Food Corporation of India (FCI), Fertilizer companies and Oil Marketing Companies etc. Even though the printed fiscal deficit data will be lower, but the actual debt burden for the government on account of window dressing will be much higher.

As on December 30, 2022, the total balance under Jan Dhan Yojana stood at INR 1,80,857 crore with 47.84 crore beneficiaries, out of which 26.54 crore are women.

In FY2022-23, 303 crore DBT transactions amounting to INR 2,98,101 crore have taken place across 318 schemes.

Source:- Hindu Business Line and Times of India

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