**Government Budget:**

**Meaning**

“A government budget is an annual financial statement showing item wise estimates of expected revenue and anticipated expenditure during a fiscal year.”

Just as your household budget is all about what you earn and spend, similarly the government budget is a statement of its income and expenditure. In the beginning of every year, government presents before the Lok Sabha an estimate of its receipts and expenditure for the coming financial year.

The government plans expenditure according to its objectives and then tries to raise resources to meet the proposed expenditure.

**Main elements of the budget are:**

(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:**

**(i) Economic growth:**

To promote rapid and balanced economic growth so as to improve living standard of the people Economic growth implies a sustained increase in real GDP of the economy, i.e., a sustained increase in volume of goods and services. Public welfare is the main guide.

**(ii) Reduction of poverty and unemployment:**

To eradicate mass poverty and unemployment by creating employment opportunities and providing maximum social benefits to the poor .In fact, social welfare is the single most important objective. Every Indian should be able to meet his basic needs like food, clothing, housing (roti, kapda, makaan) along with decent health care and educational facilities.

**(iii) Reduction of inequalities/Redistribution of income:**

To reduce inequalities of income and wealth, government can influence distribution of income through levying taxes and granting subsidies. Government levies high rate of tax on rich people reducing their disposable income and lowers the rate on lower income group.

Again, government provides subsidies and amenities to people whose income level is low. Again public expenditure can be useful in reducing inequalities. More emphasis is laid on equitable distribution of wealth and income. Economic progress in itself is not a sufficient goal but the goal must be equitable progress.

**Redistribution of income:**

Equalities in income distribution mean allocating the income distribution in such a way that reduces income inequalities and also there is no concentration of income among few rich. It primarily requires that rate of increase in real Income of poor sections of society should be faster than that of rich sections of society. Fiscal instruments like taxation, subsidies and public expenditure can be made use of to achieve the object.

**(iv) Reallocation of resources:**

To reallocate resources so as to achieve social and economic objectives .Again, government provides more resources into socially productive sectors where private sector initiative is not forthcoming, e.g., public sanitation, rural electrification, education, health, etc. Moreover govt. allocates more funds to production of socially useful goods (like Khadi) and draws away resources from some other areas to promote balanced economic growth of regions. In addition govt. undertakes production directly when required,

**(v) Price stability/Economic stability:**

Government can bring economic stability, i.e., control fluctuations in general price level through taxes, subsidies and expenditure. For instance, when there is inflation (continuous rise in prices), government can reduce its expenditure. When there is depression, government can reduce taxes and grant subsidies to encourage spending by the people.

**(vi) Financing and management of public enterprises:**

To finance and manage public enterprises which are of the nature of national monopohes like railways, power generation and water lines etc.

**Types of Budget:**

**(a) Balanced Budget:**

A government budget is said to be a balanced budget in which government estimated receipts (revenue and capital) are equal to government estimated expenditure.

Balanced Budget: Estimated Govt. Receipts = Estimated Govt. Expenditure

**Two main merits of a balanced budget are:**

(a) It ensures financial stability and

(b) It avoids wasteful expenditure.

**Two main demerits are:**

(i) Process of economic growth is hindered and (ii) Scope of undertaking welfare activities is restricted.

**Unbalanced Budget:**

When government estimated expenditure is either more or less than government estimated receipts, the budget is said to be an unbalanced budget. It may be either surplus budget or deficit budget.

**Surplus Budget:**

When government receipts are more than government expenditure in the budget, the budget is called a surplus budget. In other words, a surplus budget implies a situation where in government revenue is in excess of government expenditure.

**Symbolically:**

Surplus Budget =

Estimated Govt. Receipts > Estimated Govt. Expenditure

A surplus budget shows that government is taking away more money than what it is pumping in the economic system. As a result, aggregate demand tends to fall which helps in reducing the price level. Therefore, in times of severe inflation, which arises due to excess demand, a surplus budget is the appropriate budget. But in situation of deflation and recession, surplus budget should be avoided. Mind, balanced budget and surplus budget are rarely used by the government in modern-day world.

**(c) Deficit Budget:**

When government estimated expenditure exceeds government receipts in the budget, the budget is said to be a deficit budget. In other words, in a deficit budget, government estimated revenue is less than estimated expenditure.

**Symbolically:**

Deficit Budget = Estimated Govt. Expenditure > Estimated Govt. Receipts

These days’ popular democratic governments adopt mostly deficit budget to meet the growing needs of the people. It may be mentioned that Keynes had advocated a deficit budget to remedy the situation of unemployment and under-employment.

Government covers the gap either through borrowing or through withdrawals from its reserves. Thus, a deficit budget implies increase in government liability and fall in its reserves. When an economy is in under-employment equilibrium due to deficient demand, a deficit budget is a good remedy to combat recession.

**Merits and demerits of deficit budget:**

A deficit budget has its own merits especially for developing economy For example (i) It accelerates economic growth and (ii) It enables to undertake welfare programmes of the people, (iii) It is a cure for deflation as it checks downward movement of prices. At the same time.

**It has demerits also such as:**

(i) It encourages unnecessary and wasteful expenditure by the government, (ii) It may lead to financial and political instability, (iii) It shakes the confidence of foreign investors

The situation of excess demand leading to inflation (continuous rise in prices) and the situation of deficient demand leading to depression (fall in prices, rise in unemployment, etc.). A surplus budget is recommended in the situation of inflationary trends in the economy whereas a deficit budget is suggested in the situation of recession.

COMPONENTS OF THE GOVERNMENT BUDGET

The budget comprises of the (a) Revenue Budget and (b) Capital Budget

1. **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 receipts of the government which are non-redeemable, that is, they cannot be reclaimed from the government. They are divided into tax and non-tax revenues

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 tax1 . 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 of the central government mainly consists of interest receipts on account of loans by the central government, dividends and profits on investments made by the government, fees and other receipts for services rendered by the government. Cash grants-in-aid from foreign countries and international organisations are also included.

**Revenue Expenditure**: Revenue Expenditure is expenditure incurred for purposes other than the creation of physical or financial assets of the central government. It relates to those expenses incurred for the normal functioning of the government departments and various services, interest payments on debt incurred by the government, and grants given to state governments and other parties (even though some of the grants may be meant for creation of assets).

Budget documents classify total expenditure into **plan and non-plan expenditure.**

**Plan revenue expenditure** relates to central Plans (the Five-Year Plans) and central assistance for State and Union Territory plans.

**Non-plan expenditure,** the more important component of revenue expenditure, covers a vast range of general, economic and social services of the government. The main items of non-plan expenditure are interest payments, defence services, subsidies, salaries and pensions.

1. **The Capital Account:**

**The Capital Budget** is an account of the assets as well as liabilities of the central government, which takes into consideration changes in capital. It consists of capital receipts and capital expenditure of the government. This shows the capital requirements of the government and the pattern of their financing.

Capital Receipts:

All those receipts of the government which create liability or reduce financial assets are termed as capital receipts. The main items of capital receipts are loans raised by the government from the public which are called market borrowings, borrowing by the government from the Reserve Bank and commercial banks and other financial institutions through the sale of treasury bills, loans received from foreign governments and international organisations, and recoveries of loans granted by the central government. Other items include small savings (Post-Office Savings Accounts, National Savings Certificates, etc), provident funds and net receipts obtained from the sale of shares in Public Sector Undertakings (PSUs) (This is referred to as PSU disinvestment).

Capital Expenditure:

There are expenditures of the government which result in creation of physical or financial assets or reduction in financial liabilities. This includes expenditure on the acquisition of land, building, machinery, and equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties.

Capital expenditure is also categorised as **plan and non-plan** in the budget documents.

**Plan capital expenditure,** like its revenue counterpart, relates to central plan and central assistance for state and union territory plans**. Non plan capital expenditure** covers various general, social and economic services provided by the government.

Meaning of PB:

Performance budget may be defined as a budget based on functions, activities and projects. Performance budgeting may be described as a budgeting system, where under input costs are related to the end results, i.e., performance.

According to the National Institute of Bank Management, Mumbai, the PB is the process of analyzing, identifying, simplifying, and crystallizing specific performance objectives of a job to be completed over a period, in the framework of the organizational objectives, the purpose and objectives of the job.

It involves the evaluation of the performance of the organization in the context of both specific as well as overall objectives of the organization.

Purpose of PB:

The performance budget is an instrument through which financial resources are allocated according to purposes and objectives. The costs of various programmes proposed for achieving these objectives are clearly indicated.

It also presents data for measuring worth performance of the accomplishment of objectives set under each programme. The focus of attention is not only on expenditure but also on achievement. Both are integral parts of financial planning and expenditure authorization.

Process of PB:

PB is a technique or a method employed by any agency/department. The first stage is to decide what its goal or objective should be, the next stage is to decide on a set of programmes in order to achieve the goal and then to implement the programme.

Final stage is to evaluate the actual performance of each segment and its contribution towards achievement of its goal.

Operational Steps in PB:

(a) Formulation of objectives of the agency/department

(b) Identification of various programmes or projects, which will help the agency to achieve its objective

(c) Evaluation of the programmes in terms of benefits that they produce compared to the resources that they consume

(d) Selection of the programmes on the basis of cost benefit analysis in order to utilize the funds in the optimal manner

(e) Development of performance criteria for the various programmes (suitable work measurement units, norms, yardsticks, standards, and other performance indicators)

(f) Preparation of long-term physical as well as financial plans

(g) Preparation of the annual budget

(h) Assessment of performance of each programme and by each responsibility unit and comparison of the same with the budget

(i) Undertaking periodical review of programmes with a view to assess the strengths and weaknesses and make modification, if necessary

“Zero-based budgeting” is an approach to plan and prepare the budget from the scratch. Zero-based budgeting starts from zero, rather than a traditional budget that is based on previous budgets.

With this budgeting approach, you need to justify each and every expense before adding it to the actual budget. The primary objective of zero-based budgeting is the reduction of unnecessary cost by looking at where costs can be cut.

Zero Based Budgeting, also called ZBB, is the process of creating a budget from nothing without using the prior year’s budget or spending numbers. No activities are assumed to be untouchable. All expenses are judged and must be justified in order to remain in the budget.

Differences between Traditional Budgeting and Zero Base Budgeting

• In traditional Budgeting, the previous year’s budget is taken as a base for the preparation of a budget. Whereas, each time the budget under zero-based budgeting is created, the activities are re-evaluated and thus started from scratch.

• The emphasis of the traditional budgeting is on the previous expenditure level. On the contrary, zero-based budgeting focuses on forming a new economic proposal, whenever the budget is set.

• Traditional Budgeting works on cost accounting principle, thereby, it is more accounting oriented. Whereas the zero-based budgeting is decision oriented.

• In the traditional budgeting, justification of the line items and expenses are not at all required. On the other hand, in zero-based budgeting, proper justification is required, taking into account the cost and benefit.

• In traditional budgeting, the top management take decisions regarding any amount that will be spent on a particular product. In contrast, in zero-based budgeting, the decision regarding the spending a specific sum on a particular product is on the managers.

• Zero-based budgeting is better than traditional budgeting when it comes to clarity and responsiveness.

• Traditional budgeting follows a monotonous approach. On the contrary, zero-based budgeting follows a straightforward approach.

What are the steps to create a Zero based budget?

• Identifying the decision units that need a justification for every line item of expenditure in the proposed budget.

• Preparing Decision Packages\*. Each decision package is an identifiable and separate activity. These decision packages are connected with the objectives of the company.

• The next step in ZBB is to rank the decision packages. This ranking is done on the basis of cost-benefit analysis.

• Finally, funds are allocated on the basis of the above findings by following a pyramid ranking system to ensure maximum results.

Zero Based Budgeting Advantages

• Efficiency: Zero-based Budgeting helps a business in the allocation of resources efficiently (department-wise) as it does not look at the previous budget numbers, instead looks at the actual numbers

• Accuracy: Against the traditional budgeting method that involves mere some arbitrary changes to the earlier budget, this budgeting approach makes all departments relook every item of the cash flow and compute their operation costs. This methodology helps in cost reduction to a certain extent as it gives a true picture of costs against the desired performance.

• Budget inflation: As mentioned above every expense is to be justified. Zero-based budget compensates the weakness of incremental budgeting of budget inflation.

• Coordination and Communication: Zero-based budgeting provides better coordination and communication within the department and motivation to employees by involving them in decision-making.

• Reduction in redundant activities: This approach leads to identify optimum opportunities and more cost-efficient ways of doing things by eliminating all the redundant or unproductive activities

Although this concept is a lucrative method of budgeting, it is also important to know the disadvantages as listed below:

Zero Based Budgeting Disadvantages

• High Manpower Turnover: The foundation of zero-based budgeting itself is a zero. Budget under this concept is planned and prepared from the scratch and require the involvement of a large number of employees. Many departments may not have adequate human resource and time for the same.

• Time-Consuming: This Zero-based budgeting approach is a highly time-intensive for a company to do annually as against incremental budgeting approach, which is a far easier method.

• Lack of Expertise: Providing an explanation for every line item and every cost is a problematic task and requires training for the managers.