

DECODING THE STRUCTURE OF INDIA'S UNION BUDGET

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Abstract *In the run up to 86th Union Budget of India (including interim budgets) presented in Feb 2016, this is a modest attempt to study and understand the structure of government accounts both on the revenue and expenditure side. The Constitution of India has clearly laid down the entire procedure for preparing the Union Budget and recording all the events both on the account of revenue and expenditure. The paper attempts to study the entire process of preparing a Budget in detail. It also studies the method of recording transactions under various major and minor heads. Deficit calculation is an integral part of government Budgets in developing countries. The paper concludes with the discussion on methods and types of Budget Deficits.*

Keyword: Budget, Government, Public Expenditure, Deficit

INTRODUCTION

Article 112 of the Constitution of India states a detailed procedure for preparing the Annual Financial Statement (popularly known as Union Budget of India). The Union Finance Minister presents the Budget estimates (for the forthcoming financial year) each year on the last working day the February. The Budget is implemented from the start of the new financial year i.e. 1st April. Before that the Budget proposal needs to be passed by both the houses (Rajya Sabha and Lok Sabha) of the Parliament. In some special circumstances like election year (change in government) the Constitution also allows the ruling government to present a 'Vote of Account' or 'Interim Budget'. Where the former is a just a statement of expenditure, the latter includes both receipts and expenditure. The term 'budget' has been derived from a French term 'BOUGETTEE' which means a bag of leather. It is believed that the seal of treasury of England used to be kept in a bag of leather. Even Kings and other rulers around the world used to keep their official seal and important documents in leather cover. Currently 'A budget is a master financial plan of government. It presents the estimates of forthcoming revenue and proposed expenditure of the budget period simultaneously' (Taylor, 1961).

The Finance Minister presents a total of 15 documents while reading out the Budget speech in the Parliament¹. The

Budget document gives three sets of figure:

1. Actual figures for preceding year,
2. Budget and revised figures for the current year, and
3. Budget estimates for the following year.

The entire budget estimate is prepared by the Ministry of Finance in consultation with other ministries both at the centre and state level, representatives of industries, members of private sector, nongovernmental organisations, and other stake holders. The Finance Minister attempts to incorporate stake holder's requirements and expectations from the budget to the best possible extent.

However the given paper attempts to study in detail technical aspects of Union Budget which includes, Structure of Government Accounts, Revenue and Expenditure Side Budget, Budget Statement, and Deficit Budget to name a few.

STRUCTURE OF GOVERNMENT ACCOUNTS

Articles 266 and 267 under chapter 1, Part XII of the Constitution of India direct the government to create three accounts (also known as funds). Consolidated Fund, Public Account, and Contingency Fund are created by

¹ The Budget documents presented to Parliament comprise of Annual Financial Statement, Demands for Grants, Appropriation Bill, Finance Bill, Memorandum Explaining the Provisions in the Finance Bill, Macro-economic framework, Fiscal Policy Strategy Statement for the financial year, Medium Term Fiscal Policy Statement, Medium Term Expenditure Framework Statement, Expenditure

Budget Volume-1 and Volume-2, Receipts Budget, Statement of Revenue Impact of Tax Incentives under the Central Tax System, Budget at a glance, Highlights of Budget. These documents are mandated by Article 112,113, 114(3) and 110(a) of the Constitution of India and as per the provisions of the Fiscal Responsibility and Budget Management Act, 2003.

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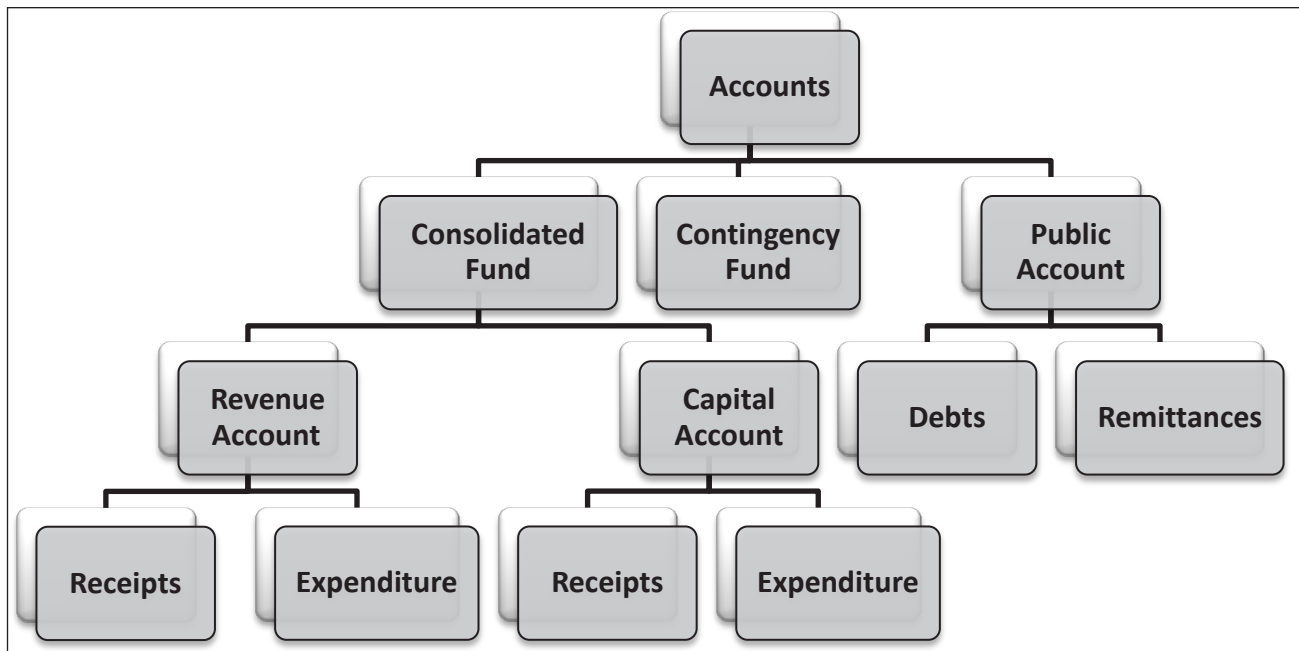


Fig. 1: Structure of Government Account

the governments both at the centre and state level. All government transactions are accounted in one of these three accounts.

Article 266(1) directs the government to deposit all taxes and duties received by the Government of India, all loans raised by the Government and all other revenue received by the Government of India into 'the Consolidated Fund of India'. Similarly all money received by the state governments on account of taxes, loans etc. shall be deposited in 'Consolidated Fund of State'. The disbursement of the fund shall be as per the law and provisions in the Constitution.

Article 266(2) directs the government to deposit all other public money received by it directly or on behalf into 'Public Account of India' or 'Public Account of the State' as the case may be. Reserve Bank of India as the banker of the Government shall keep such accounts for both centre and state governments. The Public Account shall record the transactions related to debts, deposits, advances, remittances, and suspense. The government is liable to repay the amount or make recovery if any under this account. The net funds in public accounts are available to the government as regular resources available for making expenditures.

Article 267 allows centre and states to establish a corpus of 'Contingency Fund²' by enacting a law in parliament or state legislature. Such a fund will be at the disposal of the President of India or the Governor of state as the case may be for giving advances to meet unforeseen expenditure of

the government.

The Consolidated Fund is further divided into two major accounts namely Revenue Account and Capital Account.

The Revenue Account consists of 'Receipts Heads' and 'Expenditure Heads'. The former records all proceeds of taxation and other receipts classified as revenue while the latter records all expenditure made there from.

The Capital Account also records transactions under both, 'Receipts Heads' and 'Expenditure Heads'. The former includes all borrowed funds and recoveries of loans and advances while the latter records all the expenditure which either create assets or reduce the liabilities. Expenditures under capital account are normally met from borrowed funds as the liability and benefits are spread over large number of years.

The second section under expenditure head of Capital Account deals with 'Public Debt' which includes Internal and External debt, Loans and Advances made, use of Contingency Fund and Inter-State settlement.

According to the Article 150 of Indian Constitution there should be uniformity in the structure of accounts of both centre and the state governments. Thus the accounts of the State Government too represent a similar structure. This is also because there is interrelation between the accounts of Central and State Governments due to transfer of resources from centre to state.

The Consolidated Fund is divided into broad sectors based on a group of functions or services such as Social Services and Economic Services. Sectors are further divided into

² The Government of India has established a 'Contingency Fund' under the Contingency Fund of India Act, 1950.

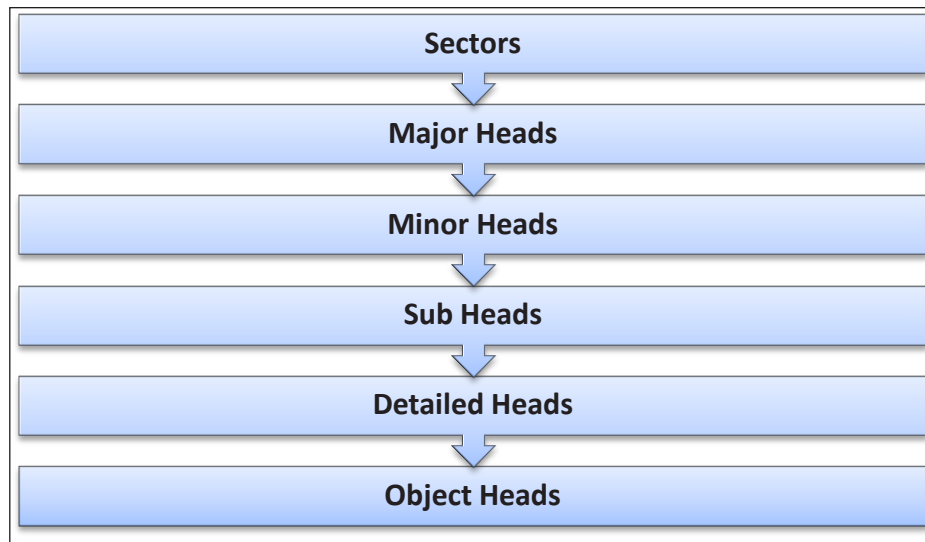


Fig. 2: Six Tier Classifications of Government Accounts

Major Heads and Minor Heads based on the programmes undertaken to enable the objectives of the service. While each scheme or policy of the government for executing the function or service comes under the Sub Head. As per the revised structure there are around 440 Major Heads in Government Account (Ganguly, 2000).

The functional classification of expenditure accounts is inflexible till the minor head as suggested by the Comptroller and Auditor General of India (CAG). These Heads of the account remain uniform between the Centre and State based on the classification of Plan and Non-Plan expenditure and Development and Non-Development expenditure. The

difference between the accounts of Centre and State starts at the level of Sub Head i.e. the schemes and programmes initiated by the government for specific purpose.

The sixth tier i.e. the object head is last but most important classification of expenditure as it provides item wise list of expenditure undertaken by the government on various schemes.

PUBLIC REVENUE

Like other economic establishments, government also needs resources to finance its activities. These funds are

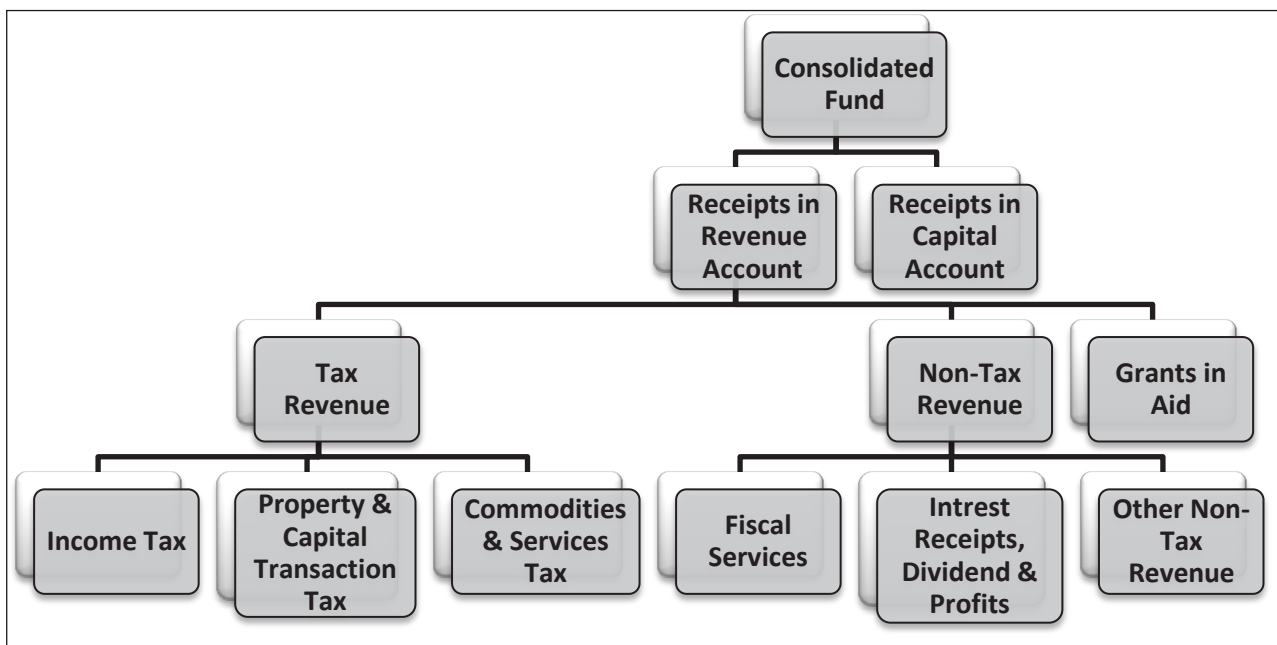


Fig. 3: Major Revenue Receipts in Consolidated Fund

raised through different sources; however the sources of the government receipts both on revenue and capital account are limited. Sources of receipts in capital account are mostly in form of borrowed funds. Capital receipts include both internal and external borrowing done by the governments. It also includes recoveries of loans and advances from state governments and other sectors if any. Finally, capital receipts will include the resources of 'Public Account'. It includes small saving amounts, provident fund, other deposits and reserve available to the central government for meeting its expenditure.

The receipts on revenue account have some extended classifications. Broadly they are classified into Tax and Non-Tax Revenue.

Tax is understood as a 'compulsory levy', those on whom a tax is imposed have to pay, irrespective of any consideration (anything in return) from the government. The benefits to be received from the government on account of social and economic grounds are irrespective of taxes paid. The tax revenue is further divided into the following:-

1. Tax on income and expenditure, this includes income tax³, corporation tax, and expenditure tax.
2. Taxes on property and capital transactions, this includes estate duty, wealth tax, gift tax, land revenue, stamp duties, and registration fees.
3. Taxes on commodities and services, this includes sales tax, union excise duty and custom duty like import duty, export duty, cess on export and other charges,

The first two items are known as Direct Taxes, where tax is collected directly from the payee on whom the tax is imposed. The incidence of such a tax cannot be transferred while the third item refers to Indirect Tax, in case of which the incidence of tax (burden) is passed on from one to another individual.

The non-tax revenue of the government is also divided into three segments.

1. Fiscal services, this includes receipts from currency, coinage and mint⁴.

³ The central government is directed through item 82 of the Union List of Schedule VII of the Constitution of India to levy income tax on all except agricultural income. The Income Tax is imposed on taxable incomes of individuals, HUFs, and other artificial legal entities like companies. The Income Tax is levied under the Income Tax Act, 1961 under the Central Board of Direct Taxes (CBDT) as part of Department of Revenue under the Ministry of Finance, Government of India.

⁴ The RBI manages Indian currency under the Reserve Bank of India Act, 1934. The printing of currency notes is done at Currency Note Press Nashik, the Bank Note Press in Dewas, the Bharatiya Note Mudra Nigam (P) presses at Salboni and Mysore and at the Watermark Paper Manufacturing Mill in Hoshangabad. While under the Coinage Act, 1960 the Government of India mints the coins and

2. Interest receipts, dividends and profits, this includes the interest receipts on loans to other governments, dividend and profits from public sector units and government undertakings.
3. Other non-tax revenue, this includes revenue receipts from various government activities, services and departments like administrative, public service, transportation, communication, postal etc.

PUBLIC EXPENDITURE

The disbursement of public revenue, also known as public expenditure can be done by the Government from the resources of 'Consolidated Fund'. However Government cannot spend any amount from the fund without a prior sanction of the Parliament. According to the Article 112 of Indian Constitution, the Government is supposed to present before the Parliament 'Annual Financial Statement' also known as Union Budget. Article 202 directs all State Governments to present a similar statement in State Legislature of the State, known as State Budget. The Budget enables the government to describe in detail proposed expenditure and disbursements under different heads and estimated receipts to meet the same.

The classification of Public Expenditure as shown in the Budget is fundamental to prepare a transparent and coherence budget (Planning Commission, 2011). Efficient budgetary expenditure classification is significant from policy formulation and performance analysis, as it will be helpful in optimum allocation of resources among various sectors. Broadly the public expenditure is divided into the following –

PLAN AND NON-PLAN EXPENDITURE

These refer to the expenditure which is covered under the provisions of prevailing Five Year Plan; however this does not mean that non-plan expenditure is unplanned. The non-plan expenditure is budgeted based on previous amounts like salaries and wages, defense, subsidies, pensions, interest payments etc. In the initial years of planning the proportion of planned expenditure mostly on capital account was much higher, as the nation required heavy investments in basic and essential sectors like infrastructure etc. Over the period of time the proportion of planned expenditure on revenue account has increased as much of the expenditure is done on the maintenance and execution rather than creating new.

supplies it to the RBI. The minting is done at Mumbai, Kolkata, Hyderabad and Noida.

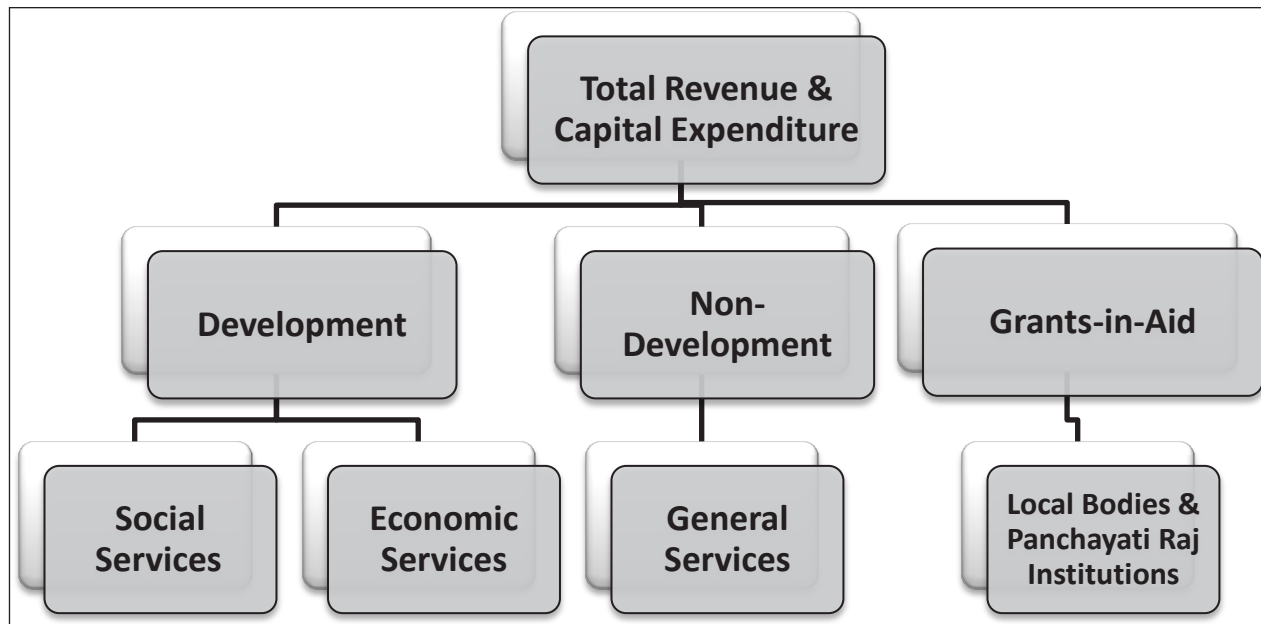


Fig. 4: Broad Classification of Revenue & Capital Expenditure

Development and Non-Development Expenditure

Since last few decades the budgetary classification of expenditure is done on the grounds of its economic usefulness. As it can be understood the former refers to the expenditure incurred to create some 'good' for the economy which directly contributes towards economic growth while

the latter refers to the expenditure incurred on running the government and economy.

Planning Commission's Report on the Efficient Management of Public Expenditure (2011) suggests that plan expenditure is mostly the expenditure incurred on the items of development and thus should be referred as development expenditure only. Moreover, there is no constitutional clarity over the terms plan and non-plan expenditure. Often non-

Social Services	Economic Services	General Services
<ul style="list-style-type: none"> • Education, Sports, Art and Culture • Medical and Public Health • Family Welfare • Water Supply and Sanitation • Housing • Urban Development • Welfare of SC, ST and OBC • Labour and Labour Welfare • Social Security and Welfare • Nutrition • Relief on account of Natural Calamities • Others 	<ul style="list-style-type: none"> • Agriculture and Allied Activities • Rural Development • Special Area Programmes • Irrigation and Flood Control • Energy • Industry and Minerals • Transport and Communications • Science, Technology and Environment • General Economic Services 	<ul style="list-style-type: none"> • Organs of State • Fiscal Services • Interest Payments and Servicing of Debt • Administrative Services • Pensions • Miscellaneous General Services

Fig. 5: Major and Minor Heads in Revenue & Capital Expenditure

plan expenditure is referred as bad expenditure, even though there are items in non-plan which created development. The planning commission (2011) thus states that the classification has become dysfunctional and largely replaced by a more functional classification of public expenditure in form of development and non-development expenditure.

As discussed earlier the public expenditure in 'Consolidated Fund' is based on the Six Tier Functional Classification. This was recommended by the Mukherjee Committee⁵ in 1974.

The sector classification for both the Revenue and Capital Expenditure is same. There are some common items both under Revenue and Capital Expenditure. These items are further classified under major heads like social, economic, and general Services. Out of which social and economic services are recorded under the broad category of Development Expenditure, while general services are recorded under Non-Development Expenditure. However some major and minor heads of expenditure are exclusively listed in Capital Expenditure. Expenditure on creation of gross capital formation, increase in stock of inventories like food supply, repayment of public debt, capital transfers to state etc. are some major capital expenditures.

BUDGET STATEMENT

From a purely economic perspective the entire budgetary function of the centre and state can be divided into Revenue

⁵ Second Report of the Committee headed by Shri A.K. Mukherjee, then Deputy Comptroller and Auditor General of India

and Capital Account.

This classification of government account gives a different perspective of all economic transactions on receipt and expenditure side. This classification is useful to determine deficit or surplus in the budget.

Revenue Account also referred as Revenue Budget compares the total revenue receipts of the government with total revenue expenditure (both on the account of plan/non-plan and development/non-development). Revenue receipts consist of all revenue sources which does not create any liability on account of the government for providing anything directly in return. The revenue receipts are also known as the real income of government. Similarly, Revenue expenditure refers to the routine expenditure of the government without creating any assets against the same. It is also known as maintenance expenditure and it is recurring in nature.

Ideally any government should be able to meet all its revenue expenditure from its revenue receipts.

Capital Account also referred as Capital Budget compares the total capital receipts of the government with total capital expenditure (both on the account of plan/non-plan and development/non-development). Capital receipts are those incomes of the government which create liability for it. These receipts are non-repetitive in nature. Capital receipts normally include borrowings of the government and other occasional receipts like disinvestment. According to the Government Finance Rules of Ministry of Finance and Government Accounting Rules laid by Comptroller and Auditor General of India the Capital expenditure refers to

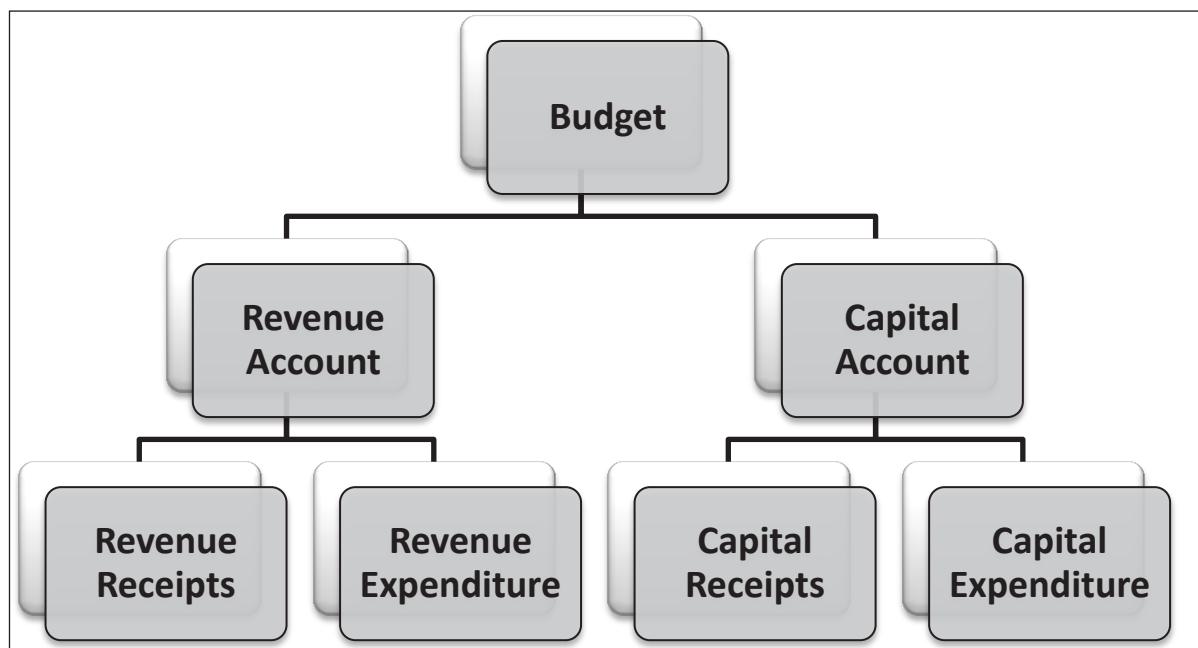


Fig. 6: Budget Statement

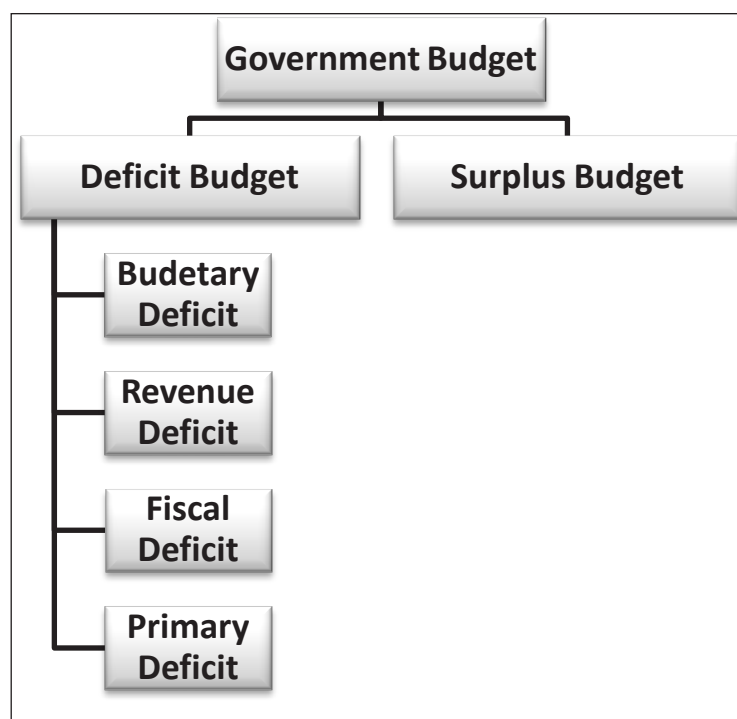


Fig. 7: Types of Deficits in Budget

the expenditure incurred by the government on building assets. This includes long term expenditure like construction of infrastructure and lending by the government. Such expenditure contributes towards capital stock of the country. For any developing country with high and growing demand for investment in basic and essentials facilities makes it difficult to meet all capital expenditure out of its total receipts, thus making further borrowing inevitable.

DEFICIT BUDGET

The deficit budget simply refers to total government expenditure greater than total government revenue. This is also known as budgetary deficit. Deficit budget was made popular and accepted by none other than *John Maynard Keynes* during 1930's. According to Keynes government should create deficit budget which can be finance through printing of new money or borrowing of idle money from the people (Chick, 1983). However it is important to understand the essence of deficit. In recent times there have been several technical concepts giving different interpretations of the term deficit being evolved.

Deficit on Capital Account

In developing countries like India the government has to spend largely upon building social and physical infrastructure. Thus the capital expenditure of the government will always remain on the higher side. On the other hand the capital

receipts are mostly borrowing and public debt. Due to this reason the capital expenditure remains higher than capital receipts creating deficit in capital account. As capital expenditure is undertaken to create public assets which will ultimately result into revenue receipts for the government, this has made capital account deficit tolerable.

Deficit on Revenue Account

Traditionally deficit has always been associated to revenue account. It simply means that total revenue expenditure of the government is higher than the total revenue receipts. In other words the government is unable to meet its current recurring expenses out of its current receipts. Large revenue deficits indicate the failure of the government in economising its resources. Most of the revenue expenditure is either consumption expenditure or transfer payments thus it does not helps in creating any further source of revenue for the government. An important argument against revenue deficit is that government will meet its revenue deficit from its capital receipts. It means that government will increase its liabilities without increasing capital assets.

The Fiscal Responsibility and Budget Management (FRBM)⁶ Act, 2003 makes it mandatory for the Central Government to achieve balance between revenue receipts and revenue

⁶ The FRBM Act, 2003 was enacted by the Parliament to develop fiscal discipline in the country, reduce fiscal and revenue deficit, improve overall management of public revenue and move towards achieving a balance budget.

expenditure and use capital receipts (including borrowings) for generating only productive assets. This is also referred as 'Golden Rule'⁷ of fiscal policy in several countries including UK, France, and Germany among others. According to the rule the government should borrow only for investment and not for financing current spending. The FRBM Act further states that government should eliminate Revenue Deficit completely within five years from the enactment of the act and thereafter create surplus in revenue account.

Fiscal Deficit

Another important deficit indicator is called as fiscal deficit. The concept of fiscal deficit in budget documents was first used in 1991 by then Finance Minister Dr. Manmohan Singh (Gupta, 2001). Fiscal Deficit is defined as the difference between government's total expenditure and total non-debt receipts. In other words the fiscal deficit refers to total receipts minus total expenditure both on revenue and capital account; however the receipts exclude all borrowings. In yet another perspective fiscal deficit refers to the dependency of government upon public borrowings for financing its expenditure. This method helps in determining the total shortfall in non-debt resources for financing government expenditure.

Fiscal deficit if not controlled will result in increasing future liabilities of the government in form of repayment of loan and interest. The FRBM Act, 2003 stated that Central government to bring down fiscal deficit and state the annual targets of reducing fiscal deficit in budget.

Primary Deficit

The concept of Primary deficit is used to define the actual dependency of government on the borrowing to meet its current expenditure. The total expenditure also includes interest payments which are to be paid due to past borrowings; they do not serve *quid-pro-quo* (something in return). Thus excluding interest payments from the total expenditure will help in determining the actual need for borrowing to meet current expenditure. The primary deficit thus is defined as Fiscal deficit minus Interest payments. In other words –

Primary Deficit = (Total Budget Expenditure – Interest Payments) – (Total Budget Receipts – Borrowings)

CONCLUSION

Post-global financial crisis, both developed and developing countries are facing problems of fiscal sustainability. Budgetary estimates (largely Fiscal Policies) of countries are

being carefully monitored to find if the public expenditure can be adequately financed from its internal and borrowed revenue without threatening the country's solvency.

Rising public debt does not necessarily create unsustainability; research has proved that if rising debt to GDP ratio positively contributes towards economic growth it is sustainable. Thus it is the nature of government expenditure incurred out of the borrowed resources that defines fiscal sustainability and not the total borrowing. Also, the future deficit values will not only depend on expenditure but also upon projected inflation, interest rate, investment rate, reserves and growth rate.

Further the problem of fiscal sustainability is not only in terms of budgetary deficit or debt but also related to types of deficit. To what extent the types of deficit affects fiscal sustainability is a matter of further research.

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⁷ The Golden Rule was first introduced in the Finance Act, 1998 of United Kingdom and later in the Code for Fiscal Sustainability approved by the House of Commons in 1998.