UNIT 6 GOVERNMENT BUDGETING: CONCEPT, FEATURES, TYPES, FUNCTIONS, AND PRINCIPLES*

Structure

6.0 OBJECTIVES

After going through this unit, you should be able to:

- Explain the meaning and the concept of government budget;
- State the objectives of budget;
- Discuss the features of budget;
- Describe the principles and types of budget; and
- Elaborate on the functions of budget.

6.1 INTRODUCTION

Budget is an important planning tool that facilitates implementation of public policies. It links proposed expenditure to future activities. It is an important exercise in government undertaken by the executive. It serves as a tool of planning, management, control, and accountability. Public funds are a key resource which are the repository of government. It needs to be spent in a cautious manner. Budget is an instrument to derive maximum public value from the activities for which money is allocated. Hence the budgetary systems management is a key component of public finance. This unit introduces the concept of budget in the context of government and orients the learners with its objectives, features, functions, and types.

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6.2 BUDGET: CONCEPT

Budget is a statement that contains a forecast of revenues and expenditure for a period that is generally one year. It is a comprehensive plan of action that provides direction for the achievement of policy objectives laid down by the government. A government budget is a document, which presents the government's proposed revenues and expenditure for a financial year that is ratified by the Parliament/ legislature and approved by the President or the Chief Executive. The Finance Minister of the country usually presents the budget.

The word budget originated from an old French word, 'bougette' which meant 'leather bag' derived from the Latin word 'leather bag' or a 'knapsack' of Gaulish origin. Sir Robert Walpole initiated the practice of presentation of budget and fiscal policy for the first time in Great Britain.

In India, the term 'budget' has not been used in the Indian Constitution though the process is usually called budgeting. The term used is 'Annual Financial Statement'. It is one of the many documents of a budget, which are presented by the Finance Minister. The budget is usually presented every year in the last week of February.

A government budget is a statement of the expected expenditure of the government and the sources of financing these expenditures during a financial year.

A budget provides information about the:

- plans, programmes, projects, schemes, and activities pertaining to the current year and proposals for the ensuing year;
- sources of finance;
- receipts and expenditure for the previous year; and
- economic and accounting data relating to the performance of various agencies of the government.

6.3 GOVERNMENT BUDGET: OBJECTIVES

A government budget has been defined as a statement showing estimated receipts and expenditure of the government during a fiscal year beginning on April 1 and ending on March 31 of the subsequent year. It is the government that takes decisions about proposed activities at all levels and requires funds to execute them. The funds are allocated through the instrument of budget, which is passed by legislature, parliament, civic bodies, etc. A budget has the power to steer the economy in a direction provided by the government. It is the most significant economic policy tool to translate the government's policies into executive action in areas that it needs to function.

Given below are some of the objectives of government budgeting:

1. **Accountability:** A government budget empowers citizens to hold public institutions accountable to ensure effective and efficient utilisation of funds. Therefore, it generates confidence in people that the money is being used for the purposes they were appropriated for.

2. **Outcomes:** The purpose of budgeting through its processes also exhibits accountability of the concerned officials/managers with respect to the outcomes

accomplished that are pre-decided in the budget. It monitors the progress of schemes and projects to assess their success.

3. **Efficiency and Economy:** The budgeting process has its methods and ways to ensure that the revenues collected, and allocated resources are being or have been spent in an economical manner.

4. **Performance Evaluation:** The laws ensure that the government is accountable for its actions. Performance evaluation through budgeting ascertains that the funds spent have achieved the targets that had been fixed. Financial reporting helps in this to assess performance of the governments pertaining to its policies and administration.

5. **Reallocation of Resources:** Over the years, as a part of budgeting process, performance evaluation has been the basis for framing the next fiscal year's budget estimates. Thus, this exercise helps the government to reallocate resources to optimise social welfare.

6. **Redistribution of Income:** The government's budgeting and its policies help in steering funds in a direction. It works for redistribution of income to attain some level of balanced economic development of society. It can increase or decrease taxation levels for a specific group or on certain commodities.

7. **Economic Stability:** A government budget aims for maintaining sustainable economic status in the country by making use of its revenue and expenditure policy.

8. **Economic Growth:** Lastly, the government tries to give an impetus to the economic growth by allocating funds and especially by investing in the economic and social infrastructure.

6.4 GOVERNMENT BUDGET: FEATURES

Most of the government budgets have certain essential features that include:

1. **Comprehensiveness:** A budget is, strictly speaking, a financial plan which sets forth the complete monetary requirements of a government for a definite period in advance and in doing so, balances expenditure needs with the anticipated income. Comprehensiveness in a budget is based on the rule of unity, which states that there must be a single fund and all money collected must be put into the Consolidated Fund. This simplifies the government transactions with efficiency.

2. **Balanced:** An essential principle is to balance the revenue and expenditure. However, in the present-day democracies, the governments are getting digressed from the characteristic of a balanced budget to meet the needs of the people through deficit financing, public debt, and public borrowing.

3. **Budget Estimates are on Cash Basis:** The money which is included in the budget is that which is realised/ received or spent during that period.

4. **The Budget Cycle:** The budgeting procedures involve:

   - Preparation of estimates keeping in view the socio-economic needs of the people;

- Examining estimates with respect to the recorded expenditure data;
- Evaluation of the government's income of the past year;
- The preparation of the budget by the budgeting agencies;
- The enactment of the bill by the legislative body; and
- The execution of the budget as per the appropriated funds by the administrative bodies.

5. **Annuality:** Most budgets are annual financial plans which require voting at regular intervals. However, it is a continuous process in which one budget is being prepared while the other is being executed.

6. **Rule of Lapse:** The budget being annual, it implies that any unspent balance at the end of the financial year, lapses and cannot be spent by the government. Fresh requisition and sanctions are needed.

7. **Predetermined Objectives:** A budget cannot be prepared without having well-laid and defined objectives to be achieved.

8. **Flexibility:** In many cases, projects face shortage of funds due to time or cost overruns, increase in the price of raw materials, etc. Since the budgets are an annual feature, there are provisions made to allocate more funds if required to implement the projects to achieve the defined targets.

9. **Accuracy:** A budget is a precise annual financial statement that is based on accuracy of estimates and expenditure incurred in the past year. The budget as far as possible is to be accurate and precise. Hence, a budget fixes the goals and targets in advance so that estimates are prepared with accuracy which are finally approved by the legislative bodies. (Mahajan, Sajeev Kumar and Anupama Puri Mahajan, 2014, *Paraphrased*).

6.5 GOVERNMENT BUDGET: PRINCIPLES

A government budget is based on principles of sound budgeting and financial management from which its characteristics and functions are derived. They are given below:

1. **Comprehensiveness:** Comprehensiveness implies a holistic approach to determine issues, comprehending all the risks and assessing the weaknesses in the institutional framework to achieve the desired targets. It also includes the budgeting office to look for the ways to improve the budgeting procedures to align and determine the government policy. Comprehensiveness also means that a budget must include all the fiscal operations of the government while ensuring that policy decisions having financial implications are made against the background of hard budget constraints and in competition with other demands. Choosing the most appropriate policy instrument to achieve a particular policy objective implies balancing the current and capital expenditure decisions.

2. **Discipline:** It is imperative that discipline is adhered to along with economy in the budgeting process and that the budget should absorb only the resources necessary to implement government policies.

3. **Legitimacy:** A budget must be ratified by the legislature to agree to the policies that had been initially agreed upon. Legitimacy also means that as far as possible decisions made during the budget process should decide how to make the best use of inputs.

4. **Accountability, Transparency, and Information:** There are interlinkages between accountability and transparency. They require that decisions with the anticipated results and the costs, be accessible, clear, and communicated to the wider community. Transparency also requires that the decision-makers have all the relevant information to make decisions.

5. **Predictability:** A budget is formulated by an aggregation of estimates that are prepared by the departmental agencies. Predictability is important for efficient and effective implementation of policies and programmes. A stable macro and strategic policy and funding of existing policy requires a timely flow of funds to programmes and projects.

Principles laid down by the Organisation for Economic Cooperation and Development (OECD)

The OECD laid down recommendations on budgetary governance, the process of formulating the annual budget, overseeing its implementation, and ensuring its alignment with public goals, setting out ten principles**.** These provide concise overview of good practices across the full spectrum of budget activity. It aims to give practical guidance on designing, implementing, and improving budget systems to make positive impact on citizens' lives.

The ten principles are:

1. Manage budgets within clear, credible, and predictable limits determined by fiscal policy.
2. Align budgets with medium-term strategic priorities of the government.
3. Design the capital budgeting framework to meet national development needs with economy and coherence.
4. Facilitate accessibility of budget documents to all by placing them in public domain.
5. Promote citizen participation in budgetary debates.
6. Preparation and presentation of reliable and accurate account of the public funds to the legislative body.
7. Execution of the budget must be proactively planned. managed, and monitored.
8. Integration of the budget process with the components of performance, evaluation, and value for money.
9. Taking cognisance of fiscal risks by prudently identifying, assessing them, and managing long-term sustainability.
10. Promote the integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation through rigorous quality assurance including independent audit.

Check Your Progress Exercise 1

Note: i) Use the space given below for your answers.

ii) Check your answers with those given at the end of the unit.

1) Explain the concept of government budget.

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2) State the objectives of government budget.

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3) What are the principles of budgeting in government?

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4) Discuss the features of budget.

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6.6 TYPES OF BUDGET

The budget is not only a statement of income and expenditure but is also a plan of action that indicates the programmes, and various activities and their operationalisation. Over time its complexion is changing. The budget as envisaged traditionally is not just a financial document. It also focuses on performance and outcomes. There are different types of budget that we shall now discuss. We shall also examine the types of union budget in India. They are:

Planning Programming and Budgeting System (PPBS)

This integrates planning and programming with the budget. It defines the objectives and identifies and evaluates the alternatives and chooses amongst the alternatives. This budget attempts to assess the effectiveness of each programme and activity with the output. It integrates planning with budgeting through programmes. This was experimented in USA but could not be properly implemented in many countries including India.

Performance Budgeting

This emphasises on examining the purposes or objectives for which funds are provided. It correlates the financial, physical aspects of each programme and activity and establishes a relationship between corresponding inputs and outputs. It is a programme of action for any given year that clearly indicates the tasks to be achieved, means and costs of achieving them. The thrust of performance budgeting is to provide output-oriented budget information within a long-range perspective so that resources can be efficiently and effectively allocated. It categorises the functions and programmes of government in tune with its policy objectives and lays down performance indicators for each programme or activity. This facilitates the assessment of costs and outputs of policies.

Zero – based Budgeting (ZBB)

This requires that organisations initially need to assess and justify their activities. Then those activities that are to be taken up are viewed afresh and accordingly the prioritisation of funds is done. In a way all budget requests are to start from base zero that is from scratch, and all the proposed activities for which money is asked are to be justified and programmes are to be ranked based on performance. The objective of ZBB is to re-evaluate all the activities every year when budget provisions are made. This helps in elimination or reduction or increasing or readjusting the funding of certain activities. It makes use of scientific methods of studying the cost-benefit aspects of projected expenditure that helps in appraising all new activities and programmes.

There are certain contemporary approaches to budgeting such as gender-based, outcome and green budgeting which shall be discussed in unit 7 of this course.

Now we shall discuss the types in which Union budget is presented in India.

REVENUE BUDGET

We shall first discuss the revenue budget. A revenue budget includes all current "receipts" such as taxation, surplus of public enterprises and expenditures of the government. The revenue receipts of the government include the revenue collected through taxes and other receipts including the items of expenditure incurred from such revenue.

Revenue Receipts: Revenue receipts comprise the income made by the government from all the sources without generating any liability or a decrease in assets. The revenue receipts have been classified into two categories – tax revenue and non-tax revenue.

i. Tax Revenue: Tax revenue is the income generated and received by the government through its taxes and duties. Taxes are of two types:

a. Direct Taxes: Direct taxes are those, which an individual has to pay without shifting its burden to any other individual or entity, and its non-payment is a punishable offence. Some examples of direct taxes are income tax, property tax, corporation tax, estate duty, etc. No gain or benefit is accrued to the payer of the direct tax.

b. Indirect Tax: Indirect taxes are those which are imposed on commodities and services, and they impact the individual's income when he/she consumes it. Unlike direct taxes, the burden can be transferred to someone else. Examples of indirect taxes are custom duties, sales tax, service tax, GST etc.

ii. Non-Tax Revenue: There are revenue receipts from other non-tax sources also.

Sources of Non-Tax Revenue

Given below are the sources of non-tax revenue:

a. Fees: This includes the fees citizens pay for availing different services availed such as the registration of property, birth, death, etc.

b. **Penalties:** Rules/regulations violations have to be handled by penalties and fines.

c. **Profits:** Profits accruing from public sector undertakings are considered as a source of non-tax revenue of the government.

d. **Gifts and Grants:** Gifts and grants from various organisations within India and from abroad or international organisations like UNICEF, UNESCO, etc.

e. **Special Assessment Duty:** This duty is levied by the government on citizens gaining because of some infrastructural development.

iii. **Revenue Receipts:** Revenue receipts include proceeds of taxes and other duties levied by the centre, interest and dividend on investments made by the government, fees and other receipts for services rendered by the government. These imply the government's cash inflow.

Revenue Expenditure

Revenue expenditure is that expenditure which is incurred for the day-to-day administration of government departments and for the provision of basic infrastructural services to the public. This also includes development and non-development expenditure of the union government. Thus, expenditure that does not culminate into assets are considered as revenue expenditure.

Some of the expenses incurred by the government that are included in the revenue expenditure are given below:

- Use of goods and services;
- Agricultural and industrial development, education, health, social services, and research on science;
- Defence and Civil Administration;
- Exports and External Affairs;
- Grants to state governments (which might be utilised for asset building);
- Loan interest payments that were made in the previous year; and
- Subsidies

CAPITAL BUDGET

The capital budget considers receipts and expenditure on capital account, as its part, to be proposed for the ensuing fiscal year.

Capital Receipts

Capital receipts are those receipts which generate a liability or a decrease in assets. Funds are raised through borrowings, loan recoveries and assets disposal.

Components of Capital Receipts

The main components of capital receipts are:

i. Market Loans: Market loans are raised by the government from the public by floating bonds and securities.

ii. Borrowings: The government resorts to borrowings from the Reserve Bank of India and other financial institutions by selling Treasury Bills.

iii. Foreign Loans: The government facilitates loans and aid from foreign countries and international agencies like the International Monetary Fund, World Bank, etc.

iv. Schemes: Funds are raised from small saving schemes like the National Savings Scheme, Provident Fund, etc.

v. Loan Recoveries: Capital receipts include loan recoveries from the States, Union Territories, and others.

Capital Expenditure

An expenditure that is proposed to generate assets with a wide span is capital expenditure.

Therefore, the above-mentioned are the components of a budget and it is essential to understand these before we discuss the budgeting process in subsequent units.

6.7 GOVERNMENT BUDGET: FUNCTIONS

A budget functions as a statement of the policies of the government to align the goals and their implementation. Budget is a policy statement. It lays down the government's policy which is translated into projects, plans and activities priorities of the government. Many governments publish a document called, 'Budget Policy Statement'. The items that are placed in the Annual Financial Statement indicate the goals the government intends to pursue. A government budget acts as a helpful tool to determine the fiscal policy by formulating plans.

Given below are the functions of a government budget:

1. **Planning**: The budget is a planning tool. It helps the public administrators in planning government operations. Budget provides a plan of expenditure for the ensuing year by indicating the projects and programmes to be undertaken.

2. **Accountability:** Budget acts as a tool of accountability. It ensures legislative control over the executive for spending the money approved heads and purposes.

3. **Responsibility and Control:** A budget ensures responsibility and popular control through the application of the budgetary procedure. It lays down plans and the means to implement them with efficiency and effectiveness. In India, legislative control is exercised by various financial committees of Parliament.

4. **Predictions:** A budget helps in making predictions based on the past year's incurred expenditure. Forecasting considers actions and targets of all stakeholders to achieve socio-economic growth.

5. **Communication:** A budget acts as a communication tool by disseminating information on implementation and outcomes of various activities, plans and programmes. A budget is a powerful aid to citizens and taxpayers as they are made aware of the amount of money that has been sanctioned for specific purposes. It is a valuable source of public information which the media and civil society organisations use to keep a watchful eye over the government.

6. **Reduction of Inequalities:** A budget aims to reduce the inequalities between income and wealth. Inclusive development can be achieved only through its

budgetary policy that provides for various forms of taxation and redistributing the revenue into social welfare programmes.

Thus, the above-mentioned functions of a budget lead to reduction in the regional disparities and a rise in economic growth.

Check Your Progress Exercise 2

Note: **(i) Use the space given below for your answers.**

(ii) Check your answers with those given at the end of the unit.

1) Explain the types of budget.

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2) What are the functions of government budget?

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6.8 CONCLUSION

A government budget has evolved over years to become an annual financial statement that has the characteristics to realise the policies into action through projects and plans. A country's socio-economic progress can be achieved by the mechanism of budgeting. Many scholars and international agencies have done research studies to improve the budgeting procedures around the globe. They have framed guidelines and principles to be followed by governments in preparing, enacting, and executing the budget.

6.9 GLOSSARY

Consolidated Fund of India: This is constituted under Article 266 (1) of the Indian Constitution includes revenues, which are received by the government through taxes and expenses incurred in the form of borrowings and loans.

Goods and Services Tax (GST): It is an indirect tax (or consumption tax) used in India on the supply of goods and services. It is a multi-stage, destination-oriented tax imposed on every value addition. It is comprehensive in nature and applied on sale of goods and services.

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6.11 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

1) **Your answer should include the following points:**

- A government budget is a government document, which presents the government's proposed revenues and expenditure for a financial year that is ratified by the legislature and approved by the President or the Chief Executive.
- In India, the term 'budget' has not been used in the Indian Constitution though the process is usually called budgeting. The Indian term used is 'Annual Financial Statement'. It is one of the many documents of a budget, which are presented by the finance minister.
- It provides information about the plans, programmes, projects, schemes activities pertaining to the current year and proposals for the ensuing year, sources of finance, receipts and expenditure for the previous year and economic and accounting data relating to performance of different government agencies.

2) **Your answer should include the following points:**

- Accountability
- Outcomes
- Efficiency and economy
- Performance evaluation
- Reallocation of resources
- Redistribution of income
- Economic stability
- Economic growth

3) **Your answer should include the following points:**

- Comprehensiveness

- Discipline
- Legitimacy
- Accountability, transparency, and information
- Predictability
- Contestability

4) **Your answer should include the following points:**
   - Comprehensive financial plan
   - Balances the revenue and capital expenditure
   - Budgetary procedure
   - Annuality
   - Predetermined objectives
   - Flexibility
   - Accuracy

Check Your Progress Exercise 2

1) **Your answer should include the following points:**
   - Planning Programming Budgeting System
   - Performance Budgeting
   - Zero – based Budgeting
   - Revenue and Capital Budgets
2) **Your answer should include the following points:**
   - Planning
   - Accountability
   - Responsibility and control
   - Forecast
   - Communication
   - Reduction of Inequalities