An Essay on the formation of 'A Budget'

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The origin of the word *budget* is the Latin *bulga*, a little pouch or knapsack, which may have come from a Gaulish source that's related to the Irish *bolg*, "bag". The word turned up in English in the fifteenth century, having travelled via the French *bougette*, a diminutive form of *bouge*, "leather bag". Its first meaning in English indeed was "pouch, wallet, bag", and followed its French original in usually implying something made of leather. By the end of the sixteenth century, the word could refer to the contents of one's budget as well as to the container itself.

The connection with finance appeared first only in 1733. By the 1760s, it was clearly well established, and has been the standard term ever since. But it was only in the 1880s that it began to be used as a verb in the sense of planning one's expenditure, and the attributive meaning of "inexpensive; suitable for someone of limited means" is first recorded only in 1958.

Centuries ago, Kalidasa,one of the greatest poets remarked, "It is only for the good of the people that the king collects taxes from them just as the sun draws moisture from the earth only to give it back a thousandfold."The science of Budgeting has come a long way from then, and today the budget is a governments' most important economic policy tool. Public budgets translate a government's policies, political commitments and goals into decisions on how much revenue to raise, how it plans to raise it, and how to use these funds to meet the country's competing needs, from bolstering security to improving health care to alleviating poverty. A budget system that functions well is crucial to developing sustainable fiscal policies and economic growth. In many countries, economic problems are exacerbated by weak budget systems and faulty budget choices. Given its wide-ranging implications for a country's people, the budget should be the subject of significant scrutiny and debate.

The real significance of the budget system is to provide for the orderly administration of the financial affairs of a government.The conduct of such affairs involves a continuous chain of operations,the several links of which are:estimates of revenue and expenditure needs,revenue and appropriation acts accounts,audit and reports.An estimate is first made of the expenditures that will be required for the proper conduct of governmental affairs during a fixed period,usually one year,together with proposals for raising resourses to meet these expenditures.On the basis of this estimate, revenue and appropriation acts are passed giving legal authority for the action determined.Following this, the operating services open revenue and appropriation accounts corresponding to the items of revenue and appropriation acts and the data recorded in these accounts are examined to ensure their accuracy and that they are in full compliance with all the provisions of law.These set of data form a report,which is the basis for the estimates of the next year and the cycle continues.

While a government's budget directly or indirectly affects the lives of every one of its citizens, it can have the greatest impact on certain groups, such as the elderly, children, the poor, rural residents, and minorities. The well being and prospects of these people can hinge greatly upon government decisions on raising and spending money. Budget cuts tend to have the greatest impact on programmes that benefit the poor and vulnerable, as other items, such as interest on the debt, the public-sector wage bill, or military expenditures, are more likely to have first claim on scarce funds. Moreover, even when funds have been allocated to specific programs—whether for minorities, children, or the disabled — weak expenditure and programme management can result in funds never reaching the intended beneficiaries.The lack of political power among these marginalized people to hold their government accountable is another factor in poor budget execution (i.e., after the budget is passed, how money is actually raised and spent).

It is critical for civil society organizations to engage in all stages in the budget cycle not only because they can contribute valuable technical skills to the process but they also have connections with the community that enable them to bring critical information about the public's needs and priorities to budget debates. In addition to representing the concerns of marginalized people, civil society can strengthen and support the ability of the poor and most vulnerable to participate in the budget process and advocate for themselves.

The Budget Cycle

The budget is more than just a single document—it is a year-long cycle whose different phases offer civil society varying access points to influence how public resources are raised and spent and, ultimately, the budget's desired outcomes.

This "budget cycle" can be broken down into four major events or stages:

- **Formulation**—when the executive branch puts together the budget plan
- **Approval**—when the legislature debates, alters (if it has the power to do so), and approves the budget plan
- **Execution (implementation, monitoring, and control)**—when the government implements the policies in the budget
- **Oversight (auditing and legislative assessment)**—when the national audit institution and the legislature account for and assess the expenditures made under the budget

With the emergence of the Welfare State, Governments have come to look after virtually every sphere of human life. They have to perform manifold functions from maintaining law and order, protecting their territories to implementation of plans for economic and social betterment. Besides, they provide a variety of social services like education, health, employment and housing to the people. Needless to say, a Government requires adequate resources to discharge these functions effectively. Where is this money to come from and who is to sanction the funds? The necessary funds are mobilised from the country's resources by way of taxes both direct and indirect, loans both long-term and short-term, to meet the Governmental expenditure. In India, the principal sources of revenue are customs and excise duties and Income-tax on individuals and companies.

Need for Budget

It is not as if the Government can tax, borrow and spend money the way it likes. Since there is a limit to the resources, the need for proper budgeting arises to allocate scarce resources to various Governmental activities. Every item of expenditure has to be well thought out and total outlay worked out for a specific period. Prudent spending is essential for the stability of a Government and proper earnings are a pre-requisite to wise spending. Hence, planned expenditure and accurate foresight of earnings are *sine-qua-non* of sound Governmental finance.

The power of producing good or bad economic effects is often attributed to policy makers. Yet, these policy makers are distinct: fiscal policy is the responsibility of the Ministry of Finance, and the monetary policy is under the jurisdiction of the Central bank. However, they are connected through the arithmetic of the Government budget constraint. In each period, the government must finance its expenditure plans. To do this, it can use taxes, offer for sale government bonds, or print money.

According to classical economists, fiscal policy has a minimum range of operations and the budget should be balanced annually. Sticking to the doctrine of *laissez faire* and Say's law of markets, they believed that when supply creates its own demand, general overproduction or involuntary unemployment is impossible. They condemned all budget deficits which necessiated borrowing by the government, for they lead to inflation and even if they did not they caused reduction in the accumulation of private capital, inhibiting the rate of progress. The balanced budget principle was recognised as a principle of sound finance in orthodox economics.

Under the theory of sound finance, classical economists favoured a balanced budget criterion for the following reasons:

i) if the budget is unbalanced, the government has to borrow. The government's market borrowing causes a reduction in loanable funds available to private productive employment and investment activities.

ii) unbalanced budgets imply a wide extension of state functions beyond the capacity of the government, which may invite irresponsible governmental action.

iii) unbalanced budgets may generate inflation on account of large and unproductive public expenditure

iv) a seies of unbalanced budgets imply an increase in the burden of public debt

v) when the debt matures, the government will have to impose additional taxes to obtain resources for its repayment, causing an adverse effect on the incentive to work and save.

The classical economists firmly advocated the unhampered operation of the free enterprise economic system. Neo-classical economists however, realised the socially undesirable effects of unregulated free enterprise on the economic system. It was argued, that careful state action for raising income and public spending was essential to attain maximum social welfare under the concept of welfare state developed in the neo-classical era.

Under the welfare state criterion, it was accepted that the state should take up the responsibility of correcting the misallocation of resources that was guided by the private profit motive.Pigou and Marshall, favoured equi-marginal social sacrifice and benefits as essential in the government budget.

The concept of fiscal policy received a new vista with the inception of New Economics in modern times through the Keynesian Revolution.

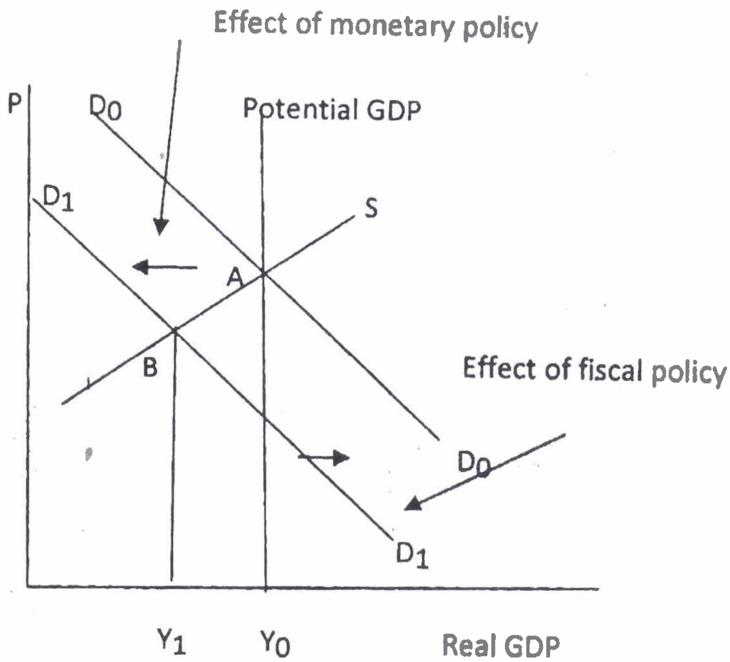
Keynes' theory shattered the basic foundation of the classical doctrine,when the former asserted that the competitive process of free enterprise economy does not necessairly ensure an effective demand such as to absorb all productive resources at full employment ,supply does not create its own demand and the economy may still attain equilibrium at underemployment level.Underemployment may exist due to secular forces causing underconsumption and oversaving in an advanced economy, thereby creating a condition of plenty in the midst of poverty on account of deficiency of aggregate demand. Keynes therefore regarded the inevitability of a positive fiscal polcy as follows: At a level of income corresponding to full employment, the gap between total income and total consumption is so high in a mature economy that private investment is inadequate to fill it. If unemployment is to be avoided, the gap must be filled either by the governmnent expenditure or by increasing the propensity to comsume.But, in a capitalist economy which is characterised by wide inequalities in the distribution of income and other institutional factors which make for high propensity to save, the propensity to consume cannot easily be raised enough to have a significant effect upon employment.Therefore the chief responsibility for maintaining high levels of employment falls on the public expenditure designed to narrow the gap between income and consumption at full employment. During a depression in an advanced economy, when aggregate spending is inadequate to achieve fill employment, the government must increase spending directly, by undertaking public works programmes on a large scale and indirectly by inducing people to spend more.

The Keynesian revolution in economic thinking reconstituted the whole basis of public finance and affirmed functional finance as a fiscal norm in modern times. Prof.A.P.Lerner contends that the fiscal operations of the government—taxing, borrowing, public spending, management of public debt, deficit financing , etc.—should be designed with the objective of fulfilling certain functions which have an immediate bearing and far reaching effects on the economic system as a whole. In economic philosophy, the term "functional finance" embraces public expenditure, public revenue and debt management which are regarded as fiscal instruments effectively used to achieve objectives like attainment and maintenance of full employment with economic stability. Contrary to the classical notion, the concept of functional fiscal policy suggests that the state need not and should not assume a passive role in the economic affairs of the country. It implies that public spending may be incurred not merely for the sake of its direct benefits, but for the sake of the indirect effects it produces in raising the level of income, output and employment , and public revenue may be raised not to meet an anticipated expenditure , but to curtail excessive demand and curb inflationary potential in the economy.The main tenent of functional finance is the formation of an unbalanced budget from time to time for perfecting the counter-cyclical goal of fiscal policy. A surplus budget is recommended during inflation and a deficit budget for recovery through excessive public spending during a depression

In the early 20th century, few industrialized countries had large fiscal deficits. This changed during the First World War, a time in which governments borrowed heavily and depleted financial reserves. Industrialised countries reduced these deficits until the 1960s and 1970s despite years of steady economic growth. Budget deficits as a percentage of GDP may decrease in times of economic prosperity, as increased tax revenue, lower unemployment and economic growth reduce the need for government programs such as unemployment insurance. If investors expect higher inflation rates, which would reduce the real value of debt, they are likely to require higher interest rates on future loans to governments.

However fiscal policy is not the only way for the government to affect aggregate demand.It can influence the aggregate demand through its monetarypolicy. Although a balanced budget may be appropriate under one monetary policy, a deficit or a surplus may be appropriate under another monetary policy.

Suppose for instance, parliment believes that the aggregate demand and supply curves intersect approximately at full employment if the budget is balanced.Then a balanced budget would seem to be the appropriate fiscal policy.But supposing, at this time monetary policy turns contractionary, pulling the aggregate demand curve inwards to the left as shown in the following figure, it will create a recessionary gap. If the fiscal authorities wish to restore GDP to its original level, they must shift the demand curve back to its original position, D_0D_0, as indicated. In order to do so, they must either raise spending or cut taxes, thereby opening up a budget deficit. Thus a tightening of the monetary policy changes the approproate fiscal policy from a balanced budget to a deficit, because both monetary and fiscal policies affect aggregate demand.



Using the same argument, a given target for aggregate demand implies that any change in the fiscal policy will alter the appropriate monetary policy.We can interpret the figure above as indicating the effects of increasing the budget deficits by raising government spending or cutting taxes.

Countries can counter budget deficits by promoting economic growth, reducing government spending and increasing taxes. By reducing onerous regulations and simplifying tax regimes, a country can improve business confidence, thereby prompting improved economic conditions while increasing treasury inflows from taxes. Reducing government expenditures on social programs and defense and reforming entitlement programmes, such as state pensions, can result in less borrowing.

It is important for us to remember that money is merely a ticket embodying command over services and goods. It is those, not the money that represents them, which constitute the real object of all transactions. And it is through them that the budget affects all economic activities of society.The Budget is thus an important tool of financial administration and an effective means of enforcing state fiscal policies.

Budgets can be classified as follows:

Revenue and capital budget: A revenue budget is concerned with revenue receipts-both tax revenue and non-tax revenue and the expenditure met out of revenue receiptsThe former can be broken up into revenue from direct taxes (personal income tax, corporation tax, wealth tax,etc).Major items of non-tax revenue are earnings from coinage and mint, public property-forests, irrigation works,etc.,earnings from public sector and departmental undertakings such as the railways, post and telegraphs, and interst on loans advanced.The revenue account covers those items which are of a recurring nature.

Revenue expenditure is further divided into plan and non plan revenue expenditure.

Plan revenue expenditure pertains to central plan and central assistance for states and union territory plans. Non plan revenue expenditure covers a wide variety of general, social and economic services of the government. The major items of non-plan revenue expenditure are interest payments, defence services and subsidies.

Capital budget comprises capital receipts and capital expenditures of the government.

Capital receipts include market loans, borrowing from the Central bank and others. Capital receipts of the government are those which create liability or reduce financial assets, while those expenditures of government which lead to the creation of physical or financial assets or reduction in recurring financial liabilities fall under the category of capital expenditure. Such expenditures pertain to payments on acquisition of assets like land, buildings, machinery, equipment, etc.

Legislative and Executive Budget:

A legislative Budget is prepared by the various committees appointed by the legislature from among its members. An executive budget, on the other hand, is the one which is prepared by the executive branch of the government. Such a budget is normally passed and adopted by the legislature but the initiative is in the hands of the government. It is generally believed that an executive budget is preferable to the legislative one, because of the following reasons:

Firstly, the executive is better equipped to estimate properly the various probable receipts and required expenditures.

Secondly, it is the executive which will be responsible for the execution of the budget in any case.

Thirdly, when the executive prepares the budget, it can be more directly held responsible for any shortcomings and lapses.

Conventional and Cash Budget:

In the conventional budget, revenue and expenditure are shown on accrual basis and those flows of funds are excluded which do not belong to the government. In the cash budget, all the flows of funds to and from the government on actual payment basis are shown, inclusive of funds which are not owned by the government. The conventional budget always presents an inadequate picture of the government activities and as the receipts and payments falling due in a period generally differ fron the ones actually made, there tends to be a distortion of the actual picture of the flow of funds caused by government activities. Cash budgets on the other hand are invariably larger than conventional budgets and are a better representative of reality.

Unified and Multiple Budget:

In USA, there was a tradition to divide the budget into parts, to make it possible to evaluate specialized functions of the government. But it is now felt that true fiscal operations of the government gets scattered and difficult to trace in case of multiple budgets

Balanced and Unbalanced Budget:

A budget is said to be balanced when the proposed expenditure and the anticipated rvenue are equal. However, a balanced budget is an accounting concept only. It is simply a balance sheet approach.

An imbalance may arise in the budget due to excess of expenditure over income or an excess of income over expenditure.

Surplus and Deficit Budget:

When public revenue exceeds public expenditure, it is called a surplus budget. Earlier, a surplus budget was a common feature of an economy.

A deficit in the budget arises when the proposed expenditure exceeds the anticipated income.In most planned economies; the government usually prepares a deficit budget so as to meet development expenditure. A deficit budget increases the liability of the government or it decreases it reserves.

Interim, Supplememtary and Emergency Budget:

A budget that is prepared for an interim period, *i.e.*less than a full year because of a delay in preparing a regular budget is known as an interim budget.

In case, during the course of a regular budget, the expenditure exceeds the revenue or the government is required to incur expenditure on some specific project for which no provision was made in the regular budget, a supplementary budget is prepared.

An emergency budget is prepared to meet an emergency situaton such as war, unusual depression, natural calamities, etc.

Budget of the Union Government in India:

In India, the Constitution demands that the budget must distinguish expenditure on Revenue Account from other expenditure. Accordingly, the budget is necessarily presented into two parts, namely Revenue Budget and Capital Budget.

India's public finance system follows the British pattern.The Indian constitution establishes the supremacy of the bi-cameral parliament, specifically the Lok Sabha in financial matters. No central government taxes are levied and no government expenditure from public funds can be disbursed without an act of parliament, which also scrutinizes and audits all government accounts to ensure that expenditures are legally authorised and properly spent. The minister of finance is required to submit to Parliament, usually on the last day of February, a financial statement detailing the estimated receipts and expenditures of the central government for the forth coming financial year and a financial review of the current fiscal year

The budget process in India, like in most other countries, comprises four distinct phases.

1. Budget formulation: the preparation of estimates of expenditure and receipts for the ensuing financial year;
2. Budget enactment: approval of the proposed Budget by the Legislature through the enactment of Finance Bill and Appropriation Bill;
3. Budget execution: enforcement of the provisions in the Finance Act and Appropriation Act by the government—collection of receipts and making disbursements for various services as approved by the Legislature; and
4. Legislative review of budget implementation: audits of government's financial operations on behalf of the Legislature.

As per the Constitution, the Union budget is to be presented in the Lok Sabha on such a day as the President may direct. The Union budget has been presented in Lok Sabha by the finance minister on the last working day of the month of February every year.

The finance minister, by convention, makes a speech while introducing the budget. The annual financial statement is laid on the table of Rajya Sabha only after the finance minister concludes his budget speech in Lok Sabha. The budget documents are made available to the members of Parliament after the finance bill has been introduced in Lok Sabha, and the House has been adjourned for the day.

The budget process in India lacks transparency in one aspect: while enactment of the Budget by the legislature and the review of its implementation are reasonably transparent, the process of budget preparation by the government is carried out behind closed doors.

Parliament's powers to amend or modify the budget are very restricted. Parliament may reduce or reject it, but it does not have the power to alter it in any substantial manner. A democratic Parliament should reconsider the prevailing system and establish new practices of transparency and participation in budget making. Indeed, Parliament should have a significant role in the budget making process.

There are some negative myths about parliamentary involvements in the budget making process. For instance, there is the myth that a closed budget process is essential, because the information involved is said to be very highly sensitive in terms of its impact on the economy and markets.In fact, there is little concrete evidence to prove this. But secrecy and a closed budget process provide space for corruption, inefficiency and speculation.The finance ministry also has to have consultations on more broad lines with the public, including civil society organisations.

In order for civil society and the public to be able to influence budget decisions and provide effective independent oversight throughout the process, there are a set of documents that should be produced and made public at each stage. The information in these documents should be comprehensive and accessible, and they should be made available in a timely way to support effective public participation.

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