BUDGETARY PROCESS AND TAXATION

Paper – VI Business Environment
MBA (Evening) 3^{rd} Year

COVERAGE

- What is Budget?
- Components of a Budget
    - Revenue Receipts / Revenue Expenditure
    - Deficit [CONCEPT AND ITS ECONOMIC IMPORTANCE]
    - Types of Deficits – Budgetary, Fiscal, Revenue, Primary and Monetized
- What is Taxation?
- Types of taxation
    - Income Tax, Expenditure Tax, Agricultural Tax, Services Tax, MODVAT [SHORT NOTE]
    - Direct and Indirect Tax [COMPARISION AND ECONOMIC CONSEQUENCES]
    - Progressive / Proportional / Regressive Taxation [SHORT NOTE]
    - Incidence of Taxation [SHORT NOTE]

MAIN REFERENCES

Indian Economy – Problems of development and planning
Silver Jubilee (1999) Edition
By A.N. Agarwal. Publisher – Wishwa Publisher

Topic Area	Chapter
1. Central Finances and New Fiscal Policy	40
2. Tax Structure : Problems and Reforms	41
3. Agricultural Tax / MODVAT etc,	42

OTHER BOOKS FOR REFERENCE

Indian Economy
By Mishra & Puri

Indian Economy
By Dutt & Sundaram

Any good book on Public Finance

NOTE:

1. Students are advised that this handout is meant as a guide and as a short introduction to the main topic. It should not be confused with course material.

2. Students should treat the handout as indicative outline as to how to approach the topic under consideration. They are expected to build up their answers taking into consideration the reference material – given above and in the course – along with class notes, newspaper & magazines etc. Answers by the students should reflect an understanding of the theory and it's implications in the current economic scenario incorporating recent changes, if any.

THE BUDGETARY PROCESS

Components of Indian Budget:

	Component		1990 – 91 (Actuals) Rs. in Crores
1.	Revenue Receipts	{2+3}	66,047
2.	Tax Revenue (net to Centre)		50,070
3.	Non Tax Revenue		15,977
4.	Capital Receipts	{5+6+7}	38,528
5.	Recoveries of Loans		6,020
6.	Other Receipts		3,038
7.	Borrowings and Other Liabilities		29,470
8.	Total Receipts	{1+4}	1,04,575
9.	Non Plan Expenditure	{10+11}	80,469
10.	On Revenue Account		67,234
11.	On Capital Account		13,235
12.	Plan Expenditure	{13+14}	30,961
13.	On Revenue Account		15,074
14.	On Capital Account		15,887
15.	Total Expenditure	{9+12}	1,11,430
16.	Interest Payment		26,563
17.	Revenue Expenditure	{10+13}	82,308
18.	Capital Expenditure	{11+14}	29,122
19.	Revenue Deficit	{1-17}	16,261
20.	Budgetary Deficit	{8-15}	6,855
21.	Fiscal Deficit	{(1+5+6)-15} = {7+20}	36,325
22.	Primary Deficit	{21-16}	9,762
23.	Monetized Deficit*		5,508

* : Expected level of Reserve Bank of India's support to Central Government borrowings

Definitions

1. Revenue Deficit: Revenue deficit is nothing but the difference between the revenue receipts and revenue expenditure. The expenditure on revenue account is of the nature that creates non earning assets – for example expenditure on civil administration, law and order, defense etc. The larger the revenue deficit, the more the government has to resort to borrowings – either internal or external and / or increase taxation to meet the deficit gap.

2. Budgetary Deficit: Budgetary deficit is nothing but the difference in total government earnings (receipts) and the total government expenditure. In India, budgetary deficit is covered mainly by creation of new money (called deficit financing). Creation of new money leads to an increase in the money supply and consequently to inflationary rise in prices. Some economist believe that Budgetary deficit does not reflect the true picture of a government's deficit because it is an accounting entity which can be easily manipulated.

3. Fiscal Deficit: Fiscal deficit is one of the more comprehensive measure of government's deficit. It can be looked upon as the sum of budgetary deficit and borrowings and other liabilities of the government. In other words, fiscal deficit reflects the indebtedness of the government i.e. the country's ability or the inability to repay loans. International Monitory Fund (IMF) usually looks at the country's fiscal deficit to determine how healthy the economy is.

4. Primary Deficit: Primary deficit is equal to the Fiscal deficit less interest payments. The concept of primary deficit was introduced for the first time in the budget of 1993-94. This indicates the real position of the government finances after having paid off the interest burden.

5. Monetized Deficit: Monetized deficit is indicated by the increase in holdings of treasury bills by the Reserve Bank of India and it's contribution to the market borrowings of the government. This it shows the extent of deficit financing (creation of new money) on the part of government.

Components Of Government Receipts:

1.1 Revenue Receipts

1.1.1 Tax

- Direct Tax
- Indirect Tax

1.1.2 Non Tax

- Interest Receipts
- Dividends / profits from PSU's
- Levies / Fees / duties charged for providing services
- External Grants etc.

1.2 Non debt capital receipts

1.2.1 Recoveries from loans

1.2.2 Miscellaneous Capital receipts

Components Of Government Expenditure:

2.1 Non Plan Expenditure

2.1.1 Interest Payment
2.1.2 Defense
2.1.3 Subsidies
2.1.4 Grants in Aid
2.1.5 Loans etc.

2.2 Plan Expenditure

2.2.1 Expenditure on Central Plan
2.2.2 Central Assistance to State / UT's

Sources of financing the fiscal deficit:

a. Domestic Borrowing (~ 96%)

- Market Borrowing
- Accruals / Savings in Public accounts
- Issue of 91 days Treasury Bills

b. External Borrowing (~ 4%)

TAXATION

Definition:

Tax is a compulsory levy imposed on the citizens of the country by the government, in exchange of which the citizen cannot claim anything from the government.

Features:

1. Tax is a compulsory levy on all citizens who have reached the taxable level of income.
2. Tax cannot be avoided on the pretext that the government failed to deliver a particular level / type of service in lieu of the imposed tax.

Objectives of imposing tax:

1. To raise revenues for the government e.g. Sales tax
2. Control undesirable affects of a particular trade e.g. tax on cigarettes
3. As a protection given to domestic industries e.g. import duties
4. To remove inequities in the distribution of wealth e.g. income tax.

Features of a good tax system:

1. <u>Equity</u>: Taxes levied should be fair to all. Apart from the ethical desirability o equity there is a practical need for tax to be accepted by the tax paying public otherwise it may lead to tax evasions thereby defeating the whole purpose of imposing tax.

2. <u>Neutrality</u>: Tax should be neutral in it's impact. Or in other words tax should not lead to market distortions. For example heavy tax on a product make the business unprofitable (or less lucrative) and force the producers to leave the market. Tax on goods with inelastic demand cause, in general, a lesser distortion in the market.

3. <u>Certainty:</u> Certainty implies the degree of confidence with which the tax authorities can look forward to the revenue which occur. Certainty of tax is dependent on the government's ability to correctly assess the tax pool.

4. <u>Evidence:</u> Evidence of a tax means the extent to which the tax payer is made aware of his duty to pay taxes, and his willingness to pay his taxes. A citizen, for example, expects a minimum level of public goods and services from the government in lieu of his tax payment. More evident the taxation benefits - more eager are the citizens for paying their taxes.

5. <u>Administrative efficiency</u>: In simple words it means that the amount of money spent on collecting the tax should be much less than the amount of money collected from the tax; otherwise the whole idea of taxation becomes and exercise in futility.

6. <u>Economic Efficiency</u>: Economic efficiency means the ability of the tax to restrain private expenditure and / or to direct the expenditure into more desirable venues.