University of Jammu

Syllabus

Semester-VI Course Code: UECTE: 602

Title: Public Finance Credits: 6

Preamble: This course on Public Finance will provide the students a thorough understanding and knowledge of Government finances with special reference to India. It will focus on essential aspects of public and private finance, principle of maximum social advantage, public expenditure, public revenue, taxation, public debt, and public budget.

UNIT 1: Nature and Scope of Public Finance

Public Finance: Meaning and Scope; Distinction between Public and Private Finance; Role and Importance of Public Finance in Developing Economies; Principle of Maximum Social Advantage.

UNIT 2: Public Expenditure

Public Expenditure: Meaning and Classification; Distinction between Public and Private Expenditure; Canons of Public Expenditure; Effects of Public Expenditure, Causes of Growth of Public Expenditure in India, Control and Accountability of Public Expenditure.

UNIT 3: Taxation

Sources of Public Revenue; Taxation: Meaning and Classification; Canons of Taxation; Factors determining Taxation Capacity, Characteristics of Good Tax System; Major Trends in Tax Revenue of Central and State Governments in India. Basic Features of GST

UNIT 4: Public Debt

Public Debt: Meaning and Objectives; Distinction between Public and Private Debt; Sources of Public Borrowing: Effects of Public Debt; Methods of Debt Redemption: Growth of India's Public Debt; Public Debt Management

UNIT 5: Public Budget

Public Budget: Meaning. Definitions and Objectives; Characteristics of Public Budget; Canons of Public Budget; Kinds of Public Budget; Preparation and Presentation of Public Budget; Importance of public budget.

Note for Paper setting: The question paper will contain three sections. In the first section, five short answer questions representing all units i.e. at least one from each unit having 70-80 words in approximately 6 minutes time and having 3 marks each (all compulsory). Five medium answer questions representing all units Le at least one from each unit having 250-300 words in approximately 12 minutes and having 7 marks each (all compulsory). Four/Five long answer questions representing whole of the syllabus with detailed explanation within 500-600 words in approximately 30 minutes time and having 15 marks each (two to be attempted).

UNIT -1 : NATURE AND SCOPE OF PUBLIC FINANCE

MEANING OF PUBLIC FINANCE

The word Public Finance is a combination of two words, Public and Finance. Public is a collective name for the individuals living within an administrative territory. It is used to signify the Government or State which represents the public. Public authorities include all sort of governments whether it may be central, state or local, while the word Finance simply means income and expenditure. Therefore, Public Finance comes to be the science of the income and expenditure of the governments whether it is central government, state government or local government. It is thus concerned with the use and accomplishment of the essential monetary resources of the Governments.

According to. C.F. Bastable, "Public Finance deals with expenditure and income of public authorities of the state and their mutual relation as also with the financial administration and control."

In the words of Prof Hugh Dalton, "Public Finance is one of those subjects which are an the borderline between economics and politics. It is concerned with the income and expenditure of public authorities, and with the adjustment of the one with the other."

According to. Philip E. Taylor, "Public Finance deals with the finance of the public as an organized group under the institution of government. It thus deals only with the finances of government. The finances of government include raising and disbursement of government funds."

In the words of Prof. J.K Mehta defines, "Public Finance constitutes study of the monetary and credit resources of the state."

SCOPE OF PUBLIC FINANCE

The contents or main divisions or scope or subject-matter of public finance includes the following:

(1) Public Revenue.

Under this section, we study all the sources from which the Government - Central, State or Local- derives its revenue or income. An extensive study of the principles of taxation is an integral part of this section. Within the purview of public revenue, we take up the classification of public revenue, canons and justification of taxation, the problem of incidence and shifting of taxes, effects of taxation etc.

(2) Public Expenditure.

Public expenditure is the end and aim of the collections of revenues. Therefore, in public expenditure we are concerned with the principles and problems relating to the expenditure of public funds. Here we study the fundamental principles governing the flow of funds into different channels, classification and justification of public expenditure, expenditure policies of the government and the measures adopted for keeping check on public expenditure.

(3) Public Debt.

Like a private individual, the government also requires loans to meet certain situations created by war, famine, floods or other calamities. As a matter of fact, government expenditure usually exceeds its income. To meet the deficit in the budget, the government borrows money from the public by way of loans which are to be repaid on due dates. Modern governments also borrow from the public to promote rapid economic development of the country. As a matter of fact, governments are forced to borrow from the people as well as from the international institutions like the World Bank and the foreign governments.

(4) Financial Administration.

The scope of public finance is not confined only to public revenue, public expenditure and public debt. We have to examine the mechanism by which the above processes are carried on. No financial treatise can be regarded as complete unless it considers the problem of financial administration. Therefore, under fiscal or financial administration, we are concerned with the machinery of the government that is in the charge of performing financial functions of the state. Preparation of budgets and its final acceptance by the legislature , as a check on its expenditure through auditing of accounts etc. constitutes an important past thereof.

(5) Economic Stabilization.

This section is of recent origin. Under this section the use of fiscal policy is studied so as to bring economic stability in the country. Fiscal policy occupies important place in the economic system of a country. Through this policy under economic system balance is maintained in the public sector in such a way as to achieve the target of public welfare. It has a wide scope to play especially in the less developed countries like India, Pakistan etc. The main task of this section is to frame and look after the implementation of various policies required for economic stabilization and growth.

Though the scope of public finance consists of the above five sections, not all of them have been given equal importance by writers on the subject. For instance, the last section - economic stabilization - is of the recent developments arising out of the peculiar economic conditions through which the world is passing. It should be remembered that the above five sections comprising the scope of public finance are not distinct and separate from one another but are intimately related to one another.

We must also keep in mind the fact that the scope and subject matter of public finance is not static but dynamic in the sense that it is continuously widening with the change in the concept of state, functions of the state and the changing problems of economics. The techniques of raising public income, public expenditure and public borrowing are swiftly changing, economic and social responsibilities of the state are increasing quite rapidly, new problems of defence and public administration etc. are growing. Besides these major factors, other factors too are responsible for widening the scope and subject-matter of public finance.

DIFFERENCE BETWEEN PUBLIC AND PRIVATE FINANCE

To explain the difference between public and private finance, it is very important to study the similarities and dissimilarities of public finance.

Similarities between public and private finance

(1) Satisfaction of Human Wants. Both the public and private finance have broadly the same objective, viz., the satisfaction of human wants. Public finance is concerned with the satisfaction of social or collective wants, whereas private finance is concerned with the satisfaction of personal or individual wants.

(2) Maximum Advantage. Both the public finance and private finance try to secure maximum advantage or satisfaction. Just as private individual tries to secure maximum advantage of his expenditure, in the same way the government also wishes to obtain maximum social advantage.

(**3) Borrowings.** Both the public and private finance have to resort to borrowings when expenditure exceeds income.

(4) Income. Just as income is not fixed for public finance, so also it is not fixed in case of private finance.

(5) Problem of Adjustment of Income and Expenditure. Both public and private finance face the problem of adjustment of income and expenditure.

(6) Scarcity of Resources. The scarcity of resources is also an important factor which is common to both. They have unlimited ends whereas the resources are limited.

(7) Repayment of Loans. Both the public and private finance are required to repay the loans sooner or later as obtained by them during deficit.

(**8) Contribution to National Product.** The financial activities of both public and private finance give birth to saving, capital accumulation and investment activities by which production consumption and investment activities are boosted in a country and thereby they contribute to national product.

(9) Elasticity in Income. In private finance income is not fixed but fluctuates in accordance to the fluctuations in business activities. Similarly, in public finance income is not fixed but fluctuates in accordance with the economic conditions of the state.

(10) Labour and Capital Objective. In private finance labour and capital are used by an individual to satisfy his demands Similarly, in public finance labour and capital are used for satisfying demands of the society.

Dissimilarities between public and private finance

Dissimilarities between public and private finance are as under:

(1) Motive. The motive of private finance is personal interest or benefit, whereas the motive of public finance is social benefit or public welfare.

(2) Adjustment Approach of Income and Expenditure. Every individual tries as far as possible to adjust his expenditure to his income because his expenditure is governed by his income. He follows the principle of 'cut your coat according to cloth. On the contrary, the Government first determines its expenditure and then devises ways and means to raise the necessary revenue (income) to meet the expenditure. The government follows the principle 'cut your cloth according to coat'.

(3) Nature of Resources. The resources of an individual (private finance) are more or less limited, whereas the resources of the Government (public finance) are enormous. Government can borrow from the public (internal) as well as from external sources.

(4) Coercive Methods. An individual (private finance) cannot use coercive methods to raise his income, whereas the Government (public finance) can use coercive methods to collect revenue, e.g., tax cannot be collected without using coercive methods by the authority.

(5) Nature of the Budget. An individual (private finance) usually thinks in terms of surplus budget, i.e., spending less than the income and thus a deficit budget (spending more than the income) is always considered undesirable. On the contrary, the government may find it useful to have a deficit budget, especially in times of economic development, war etc. To maintain a surplus budget for an individual is a virtue as it implies more savings, accumulation of capital and becoming rich. On the contrary, surplus budget of the government means high level of taxation or low level of public expenditure, both of which are not liked by the society.

(6) Secrecy of Budget. Secrecy of budget prevails in private finance whereas public finance is open to all. An individual always tries to keep his accounts secret as he never wants that his competitors should know his real financial position. On the contrary, government gives utmost publicity to its budget by publishing it in newspapers etc.

(**7) Law of Equi-marginal Utility.** An individual spends his income on various items in such a manner as to secure equal marginal utilities from them. It is only by equalising the various marginal utilities that he can secure maximum utility out of his expenditure. On the contrary, the government does not give so much importance to this law.

(**8) Long/Short-term Considerations.** Private individuals incur expenditure in those fields of business where returns are quick and immediate. They as individuals keep in view the short term considerations. On the contrary, Governments incur expenditure keeping in view the long-term considerations, such as construction of multi-purpose hydro-electric projects in India, five-year plans etc.

(**9) Elasticity of Finance.** Public finance is more elastic as compared to private finance. As a matter of fact, there is not much scope for changes in private finance while drastic changes can be made in public finance, such as fresh imposition of new taxes.

(**10) Deliberation in Expenditure.** The pattern of expenditure of an individual is governed by habits, customs, status, personal needs etc. On the contrary, the pattern of public expenditure is governed and controlled by deliberate economic policy of the government.

(**11) Right to Print Currency.** The Government has a right to print currency which is legal tender within the country, whereas private individual does not enjoy such a right.

(**12) Difference of Objectives.** The existence of the state is for the welfare and security of the society as a whole and not for the good of any individual. On the contrary, the individuals or corporations think of earning and profits for themselves and also for the individual welfare as well as the safety.

(**13) Difference as to Deficit and Saving.** In private finance an individual on the contrary, always tries to draft the budget of saving. On the contrary in public finance, the state budget is always a deficit budget and hence, deficit financing.

ROLE AND IMPORTANCE OF PUBLIC FINANCE IN DEVELOPING ECONOMIES

There is great socio-economic significance of public finance, both in developed and developing countries. In developed country countries, price-stability and full employment are the main economic goals of public finance. In developing countries, rapid economic development through capital formulation and creation of infrastructure art the important goals of public finance operations. Socially equitable distributions of income, reduction of inequalities in income are some of the important functions of public finance operations. The importance of public finance can be clarified from the following functions.

1. To Increase the Rate of Saving and Investment: Most of the people spend their income on consumption. Saving is very low so the investment is also low. The government can encourage the saving and investment.

2. To Secure Equal Distribution of income and wealth: Unequal distribution of income and wealth is the basic problem of the under developed countries. The rich are getting richer and richer while the poor are becoming poorer and poorer. So for the equal distribution of income and wealth there is need of government public finance help us in achieving this objective by taxing the rich and distributing the same to the poor.

3. Optimum Allocation of Resources: Fiscal measures like taxation and public expenditure programmers can greatly affect the allocation of resources in various occupation and sectors, for its optimum allocation and utilization.

4. Capital Formulation and Growth: Fiscal policy will be designed in a manner to perform two functions as of expanding investment in public and private enterprises and by diverting resources from socially less desirable activities to more desirable investment channels. As capital formation is pre requisite for smooth economic development.

5. Promoting Economic Development: The state can play a prominent role in promoting economic development especially through control and regulation of economic activities. It is fiscal policy which can promote economic development of a nation.

6. Implementation of Planning: Under democratic planning fiscal policy plays crucial role as financial plan is as much important as physical plan and the implementation of the financial will obviously depend upon the uses of fiscal measures.

7. Infrastructure Building: Public finance helps to build up well development physical and institutional infrastructure.

8. To Control Inflation: The imbalance between demand for and supply of real resources may lead to inflations to under development countries inflation ruins the entire economic structure of the national and the process of economic development in these countries comes to stand still. So to check inflation, budgetary policies can be used by the government.

PRINCIPLE OF MAXIMUM SOCIAL ADVANTAGE

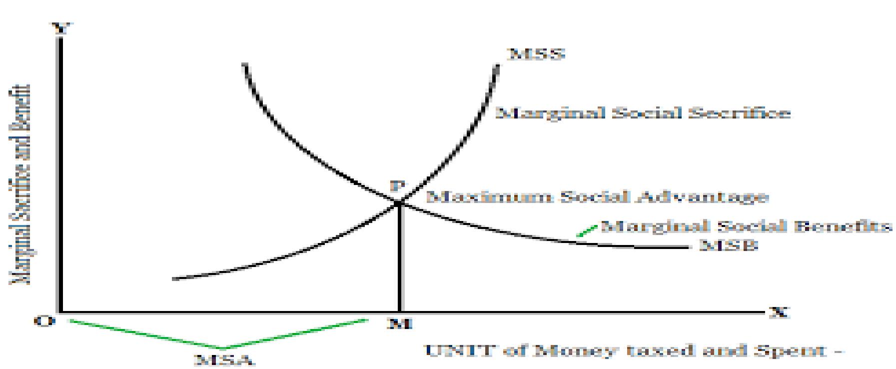
We certainly require one fundamental principle which should be at the root of public finance. Now the question arises as to what should be the sound principle of public finance. The answer the this basic question has been given by Dr. Hugh Dalton, the well-known British economist. According to Dr. Dalton, "The best system of public finance is that which secures maximum social advantage is the maxim for the state. The fiscal operations of state should, therefore, be determined by the principle of maximum social advantage. The state should always keep this principle in view while raising revenues or incurring expenditure on different heads. It should be the guiding principle in all the activities of the state.

The principle state that the state should collect revenue and spend the money so as to maximize the welfare of the community as whole. The imposition of taxation by the state involves loss of utility to those on whom it is levied, the reason being that taxation leads to some loss of purchasing power of the person on whom it is levied. This is the social sacrifice of taxation. Similarly, when the state spends money or incurs expenditure, it leads to gain of utility by those sections of the society who are benefited by it. This is the social benefit of public expenditure. Thus taxes impose a burden; expenditure relieves the people of social burden. As such, the maximum social advantage is achieved when the state in its financial activities maximizes the surplus of social gain or utility over the social sacrifice or disutility. Therefore, as observed by Dr. Dalton, "Public expenditure in every direction should be carried just so far, that the advantage to the community of a further small increase in any direction is just counterbalanced by the disadvantage of corresponding small increase in taxation or in receipt of any other source of public income." Thus, the state should not proceed beyond the point where the social benefit equals the social sacrifice. In case, it does so the net social advantage shall be less than the maximum. As a matter of fact, the net social advantage shall be maximum only at the point where the social sacrifice equals the social benefit. In other words, when the advantage conferred by the public expenditure is maximum and the aggregate sacrifice imposed by the taxation is minimum, the net social advantage is maximum. This is what every state requires. The state should compare the sacrifice and benefits of the society in its fiscal operations.

In modern times, the ultimate aim of every state, whether capitalistic or communistic (socialists), is the maximum good of the people. The financial operations of the state very much affect the welfare of the people. However, there must be some fundamental principle to guide the financial operations of the state. Economists have assigned different names to this principle. Dr. Dalton has named it is Principle of Maximum Social Advantage whereas Prof. Pigou has named it the Principle of Maximum Aggregate Welfare. In this connection, Prof. Pigou has remarked, "Expenditure should be pushed in all directions up to the point at which satisfaction, obtained from the last shilling spent, is equal to the satisfaction lost in respect of the last shilling called upon Government Services."

Diagrammatic Representation of the Principle

The principle of 'Maximum Social Advantage can be very well illustrated by means of a diagram given alongside. In this diagram, there are two curves, viz., sacrifice curve and benefit curve. MSS' is the sacrifice curve and MBB' is the benefit curve. The sacrifice curve (MSS) will be a raising (rising) curve because the sacrifice per unit of taxation goes on increasing with the increase in tax. On the contrary, benefit curve (MSB') will be a failing curve because benefits per unit decrease as the public expenditure increases. The point where both curve would meet, i.e., P would be the optimum limit of the State's financial activity. It is the point where sacrifice made as a result of taxation is equal to the benefit gained as a result of public expenditure.



CRITICISM OF THE PRINCIPLE OF MAXIMUM SOCIAL ADVANTAGE

The principle of Maximum Social Advantage has been criticized on the following grounds:

(1) Difficult to Measure Social Benefit and Social Sacrifice. The first major difficulty of this principle is that it is not possible in actual practice to measure social benefit and social sacrifice in fiscal operations of the State. Both are subjective and cannot be brought on objective plane.

(**2) Non-applicability in Borrowings.** It is not essential that the entire public expenditure may be financed by revenue raised through taxation. The public expenditure may also be financed through public borrowings. Loans raised from the public involve no social sacrifice whatsoever because such loans are repayable with interest on due dates. As such, the principle of maximum social advantage, to that extent, is rendered totally inoperative.

(**3) Bad and Good Effects of Taxation.** Under this principle, we assume that taxation itself is a loss of utility to the community. When the state imposes some taxes, some disutility or dissatisfaction is experienced in the society. The disutility is in the form of sacrifice in the payment of taxes-in parting with the purchasing power. However, it is not always true because taxation has good effects also. For example, when taxes are imposed on wine, lottery, harmful drugs etc. so as to reduce their consumption, or by it provides utility instead of any loss to the society.

(**4) Changes in Conditions.** What is good under one set of conditions may not be so under another. The conditions in the economy of a country are not static but are always changing. What might be considered as the point of maximum social advantage under some conditions may not be so under other conditions.

(**5) Significance of Problem.** To some critics, the disutility of taxation to the tax payer is a minor problem relating to individuals whereas the utility or benefit of public expenditure to the society is a macro problem concerning all.

Conclusion

Despite the above criticisms leveled against this principle, it must be recognised that the principle of maximum social advantage is of basic importance in the field of public finance.

UNIT - 2 : PUBLIC EXPENDITURE

MEANING OF PUBLIC EXPENDITURE

Public expenditure is the expenditure incurred by public authorities- central, state or local governments either for the satisfaction of collective needs of the citizens or for promoting their economic and social welfare or for protecting the citizens and the country. Just as consumption is the end of all economic activities, so also public expenditure is the end of all financial activities of the state. It is aimed to provide maximum socio-economic welfare of the society. It is considered to be the backbone of economic development of a country. Public expenditure is an important part of public finance. During past few years there has been a continuous increase in public expenditure in almost all the countries of the world, due to increasing role of state in economic activities.

In the words of Sir Henry Parenell, "Every particle of expense that is incurred beyond what necessity absolutely requires for the preservation of social order and for protection against foreign attack is waste and an unjust and oppressive imposition on the public."

CLASSIFICATION OF PUBLIC EXPENDITURE

Classification of public expenditure implies listing of state functions so that we may know their justification, scientific and economic basis, nature and effects. According to Spriegal, "A classification is a detailed, systematically arranged list of all items pertaining to a particular phase of business. Classification facilitates interpretation and ease of reference to seemingly unrelated facts. A number of classifications of public expenditure have been made by different economists from time to time and there is little agreement between them with regard to this aspect of public finance. The following are the main basis of classification of public expenditure:

Classification on the Basis of Benefit

Since the expenditure is incurred by the state with the objective of conferring benefits on the society, it can be classified on the basis of the benefits which it confers on the various sections of the society. German writers such as Prof Cohn and American writers such as Plehn have classified the public expenditure on the basis of benefit into four classes;

(i) Public expenditure benefiting the entire society, e.g., the expenditure on general administration, defence, education. public health, transport etc.

(ii) Public expenditure conferring a special benefit on certain people and at the same time common benefit on the entire community, e.g.. poor administration of justice etc.

(iii) Public expenditure directly benefiting particular group of persons and indirectly the entire society, e.g., social security, poor relief, public welfare, pension, unemployment relief etc.

(iv) Public expenditure conferring a special benefit on some individuals, e.g., subsidy granted to a particular industry.

Classification on the Basis of Revenue

Prof. F. S. Nicholson classified public expenditure on the basis of amount of revenue obtained by the state in return for the services rendered. His classification are given below:

(i) Expenditure without any direct return of revenue, e.g., poor relief as well as direct loss on wars.

(ii) Expenditure without direct but considered as productive expenditure in western countries as it is an investment in man thus considered productive of human capital. It is partially beneficial to Revenue, e.g., expenditure on education.

(iii) Expenditure with partial direct return, e.g., subsidised railway service, education for which fees are charged etc.

(iv) Expenditure with full return on even profit, e.g., gas service, post-office, public enterprises etc.

Classification on the Basis of Function

Prof. Adam Smith classified public expenditure on the basis of functions of the government performed in the following main categories:

(i)Protection Functions. This category includes public expenditure incurred on the security of the citizens, to provide them with justice and to counteract any external invasion and internal disorder, e.g., defence, police, courts etc.

(ii) Commercial Functions. This group includes public expenditure incurred on the development of trade and commerce. e.g., development of means of transport and communication, public enterprises etc.

(iii) Development Functions.

This group of expenditures includes public expenditure incurred for the development of citizens and country, e.g., education, public recreation and wealth etc.

Classification on the Basis of Importance

Prof. John Stuart Mill classified public expenditure into : (1) useful necessary, and unnecessary (2) optional. The obvious idea behind this classification seems to be the importance which the particular expenditure holds. For the welfare and overall development of the citizens G. Findlay Shirras, almost on the same basis, has classified public expenditure into two following groups:

(i) Primary Expenditure. It includes all expenditure which must be incurred by every state, e.g., defence, maintenance of law and order, civil administration, payment of debts etc.

(ii) Secondary Expenditure. It includes public expenditure on the remaining items, e.g., social expenditure, education, public health, poor relief, unemployment insurance etc.

Classification on the Basis of Necessary, Useful and Superfluous

Prof. Rosher classified public expenditure into following three groups:

(i) Necessary Public Expenditure. It includes public expenditure which the state has to incur and which cannot be postponed.

(ii) Useful Public Expenditure. It is that public expenditure which is desirable but can be postponed line govt. commitments, coupled with the concept of sovereignt.

(iii) Superfluous Public Expenditure. It is that public expenditure which the state may or may not incur line expenditure on social security measures.

Classification on the Basis of Grants and Purchase Price

Prof. Dalton classified public expenditure on the basis of grants and purchase price. When the state incurs expenditure and does not get any commodity or service in return the expenditure interned as grant line expenditure on poor relief, payments of old age social insurance etc. On the other hand when state acquires or get some commodity or service in return the expenditure in classified as purchased price like salaries of the govt. employees etc.

Classification on the Basis of Productive and Unproductive

Prof. Robinson classified public expenditure under the following two heads:

(**i) Productive Public Expenditure**. Productive public expenditure is that which directly or indirectly develops natural and human resources and increases national income.

(ii) Unproductive Public Expenditure. Unproductive public expenditure is that which does not result in any rise of national income, e.g., expenditure on war expenditure which does not add to enhancing the productive capacity of the nation or expenditure consumed in the rendering of services.

Classification on the Basis of Transferability

Prof Pigou classified public expenditure into following two groups;

(i) Transferable Public Expenditure. An expenditure is said to be transferable when it takes the form of payment of money to people either gratuitously or in purchase of existing property rights, e.g., payment of interest on government debt, pensions, sickness benefits, unemployment insurance, subsidies etc.

(ii) Non-transferable Public Expenditure. An expenditure is said to be non-transferable public expenditure when it is incurred to purchase current services of the resources of the nation, e.g., expenditure on army, navy, air force, civil administration, education, judiciary etc.

Classification on the Basis of Constant and Variable Expenditure

Prof. J. K. Mehta classified public expenditure into the following two groups:

(**i) Constant Expenditure.** The constant expenditure is that amount which does not depend upon the services that are financed by it. The expenditure on defence is a clear example of this group of expenditure.

(**ii) Variable Expenditure.** Variable expenditure is that which increases with every increase in the uses of public services by the people for whose benefit it is incurred. Expenditure on postal service is an example of variable expenditure.

Economic Classification

In modern times, public expenditure is classified under two heads:

(1) Revenue Account, and (2) Capital Account.

Under the Indian Constitution, budget has to distinguish expenditure on revenue account from other expenditure. In this way, the Government of India budget is divided into: (i) Revenue Budget, and (ii) Capital Budget. It means that the Government of India Income and Expenditure is divided into two major groups: (i) Income and Expenditure on Revenue Account, and (ii) Income and Expenditure on Capital Account.

Conclusion

We have discussed above the various classes of public expenditure. But if we minutely study all these classifications, we find that none of these appears to be a perfect one. However, the efforts made by different economists in this direction are really praiseworthy.

DIFFERENCE BETWEEN PUBLIC AND PRIVATE EXPENDITURE

Public expenditure is similar to private expenditure in some respect. But in many other respects, it is quite dissimilar to private expenditure. Similarities and dissimilarities public expenditure are discussed below.. Public and private expenditures are similar in following respects:

Similarity Between Public and Private Expenditure

(i) Both the individual and the State try to obtain maximum satisfaction out of the expenditure. Both like to obtain greatest results at the minimum of cost. In other words, maximization of returns is the common principle in public and private expenditure.

(ii) The individual and the State adjust their income to expenditure. If, for some reasons, the expenditure of an individual exceeds his income, he will try to earn more by putting hard labor or by sacrificing leisure. Likewise, the government may impose more taxes or other sources of revenue if public expenditure exceeds its current tax revenue.

Dissimilarity Between Public and Private Expenditure

Public and private expenditure differ on various counts as follows:-

(i)The purpose of public expenditure is the welfare of the society or the country but the motive of private expenditure is limited to the welfare of himself and his family.

(ii) The individual always makes an attempt to adjust his expenditure according his income whereas the government attempts first to make an estimate of total expenditure and then devise methods of raising the required revenue through various means.

(iii) The plans of private expenditure are generally short termed and are made only for the near future. Public expenditure on the other hand. is planned with the objective of long term benefits to the society.

(iv) The benefit of private expenditure can be measured with the help of the marginal utility of goods and services purchased. The benefits accrued to a private firm can also be measured in terms of equality between marginal cost and marginal revenue. But the measurement of benefits, accruing from the public expenditure is not possible.

(v) Flexibility in public expenditure is much more the private expenditure because the latter cannot be squeezed later on whereas the private expenditure can be increased or decreased according to the will of the individual..

(vi) Private expenditure is motivated by private profits where- as the main motive of public expenditure is public welfare.

Thus, it is clear that private and public expenditure differ in respect of coverage otherwise there is no fundamental difference between them.

CANONS OF PUBLIC EXPENDITURE

Canons of public expenditure or principles of public expenditure: According to Prof. Pigou, "The sole guiding principle of public expenditure is the maximum aggregate benefit." The state exists for the welfare of the people and, therefore, it should spend money in such a manner that maximum benefit is conferred on the community.

Whatever principle we may adopt in theory, there are always general rules which are adopted by respective governments in formulating their public expenditure policies. These rules are termed as principles or canons of public expenditure. According to Prof. Shirras, the following are the principles or canons of public expenditure:

(1) Canon or Principle of Benefit. According to this principle, public expenditure should be planned in such a way as to yield maximum social advantage and social welfare to the community as a whole and should not be incurred on a particular group of the community. The government should incur its public expenditure in a manner as to promote the greatest good of the greatest number. This canon also implies that the government should try, as far as possible, to reduce the current inequalities through its public expenditure, programme.

(2) Canon or Principle of Economy. Economy does not mean miserliness it only means that wasteful and extravagant expenditure should be avoided at all levels. Economy can be in two spheres. Firstly, the state should spend money only on most necessary matters, Secondly, the state should develop the productive powers of the community as much as possible. This is the positive aspect of the economy.

(3) Canon or Principle of Sanction. According to this principle before incurring any expenditure, the concerned government department should obtain prior proper sanction from the competent authority. The object of this canon again is to avoid misappropriation of public money and to secure its proper use. Only obtaining prior sanction is not sufficient. It must be properly inspected and examined whether the sanctioned amount of money is being spent on sanctioned items in a sanctioned manner. However, sanction of the higher authority is not the end in itself. It is only a proper procedure for the formulation of expenditure policy.

(4) Canon or Principle of Surplus. According to this principle public authorities should aim at surplus of income over their expenditure and that they should avoid deficits. Just as every prudent man will attempt to adjust his expenditure to his income, and if possible, to see that his expenditure is less than his income, so also every government should attempt to balance its income and expenditure and if possible, aim at moderate surplus. This canon or principle also implies that it may not be possible to achieve surplus budgets year after year but what is really required is that the government should avoid continuous deficit budgeting in the interest of its own creditworthiness.

(**5) Canon or Principle of Elasticity.** According to this principle the expenditure policy of the state should be such that changes may be possible in accordance with the requirements of different circumstances. This necessitates that the expenditure policy be elastic rather than rigid in its nature. In other words, there should be scope for changes in public expenditure according to requirements of the country. For example, there should be enough scope for a cut in public expenditure at a time of crisis, because government's income usually goes down at such a time.

(**6) Canon or Principle of Productivity.** According to this principle that the expenditure policy should be such as would encourage production in a country. In short, as per this canon or principle, the major part of the public expenditure should be allocated towards productive and developmental purposes.

(**7) Canon or Principle of Equitable Distribution.** This canon or principle implies that public expenditure should be carried out in such a way that the inequalities in the distribution of income are reduced, i.e., public expenditure should ensure just and equitable distribution of income among different groups of the community.

(**8) Canon or Principle of Coordination.** According to this principle, in case of countries having Federal or Democratic set-up, there are central, state and local governments. All these governments have their separate budget and incur expenditure accordingly. There must be close coordination between them so that there is no duplication of expenditure.

EFFECTS OF PUBLIC EXPENDITURE

Every public expenditure is considered desirable, when it is not wasteful, but has a positive effect on production, distribution, consumption, and thus maximises economic and social welfare of the country as a whole.

Effects of public expenditure on the economy of any country can be studied under the following heads:

(I) Effects on Production.

(II) Effects on Distribution.

(III) Effects on Consumption.

(IV) Miscellaneous Effects of Public Expenditure.

(I) Effects of Public Expenditure on Production

While analysing the effects of public expenditure, Dalton very correctly said that just as taxation, other things being equal should reduce production as little as possible, or the public expenditure should increase productive as much as possible. He further added that the level of production and employment in any country depends upon the following three factors:

1. Ability to Work, Save and Invest.

2. Willingness to Work, Save and Invest.

3. Diversion of Economic Resources.

(**1) Ability to Work, Save and Invest.** If public expenditure increases the efficiency of a person to work, it will promote production and national income. Public expenditure on education, medical services, cheap housing facilities, means of transport and communications, providing cheap basic necessities like water and electricity, recreation facilities etc. will increase the efficiency of persons to work. At the same time, public expenditure can promote saving on the part of the lower income groups by providing additional income to them, for a person who has larger income can be normally expected to save a larger amount. Similarly, public expenditure on increasing wages and salaries of the people, supply of goods at cheap rates and expenditure on tile welfare of the society will increase the purchasing power, standard of living, efficiency and thereby ability to work and save will also increase. Finally, public expenditure, particularly repayment of public debt will place additional funds at the disposal of those who can save.

Further, pubic expenditure incurred for maintaining law and order in the country will create confidence in the minds of the people and thereby encourage them to make investments in production activities. Thus, as production increases along with larger income in the hands of the people, their ability to work, save and invest will automatically increase.

(2) Willingness to Work, Save and Invest. Public expenditure also affects the people's willingness to work in future. Similarly, the expenditure policy of the Government influences the decisions of the people in future as to which part of their income may be available for saving and investments. If the people do not expect any rise in their income in the future, their willingness to work is certainly bound to be adversely affected. Likewise, if they consider that their present savings and investment will not earn for them any income in the future, such sharp reduction in interest rates, their willingness to save and invest is also adversely affected. Expectation of future profits accruing from public expenditure, provides a cushion for the incentive for hard work. The present generation in India is stimulated to work hard in the expectation of the larger amenities and higher standard of living which they will enjoy as a result of the larger expenditure incurred by the State in numerous public projects and Schemes. It is this expectation which has encouraged them to work, save and also to invest their savings in productive purposes.

(**3) Diversion of Resources**. Public expenditure can be diverted from private to public use in many ways which has far reaching effects on the utilisation of resources as between alternative uses. The major areas of diversion of resources are as follows:

(**i) Diversion of Resources to Unproductive Areas.** There is the diversion of public expenditure to a number of unproductive areas, such as, expenditure on armaments and armed forces, on police and on civil administration etc. Such an expenditure is often called economic waste. This type of expenditure ought to have been incurred on the social security and welfare of the society. In our opinion it is not a wastage. For example, expenditure on armaments and armed forces is a must as it reduces the danger of foreign invasion and reduces huge economic loss which would have resulted in the event of a war. Similarly, expenditure on police and civil administration is also essential for the maintenance of law and order inside the country, to any mind it is indirectly a productive expenditure.

(ii) Diversion of Resources for Providing Infrastructure. There is also the diversion of resources from the private to public use by incurring expenditure for providing infrastructure, such as, roads, railways, irrigation projects, water and electricity etc. This diversion is a must in all types of economies, i.e.. developed, developing and even underdeveloped.

(iii) Diversion of Resources for Social Security and Welfare Activities. Diversion of resources is also essential for conducting social security and welfare activities, such as encouragement to research and inventions, promotion of education, training, public health, sanitation, social security schemes, old-age pensions etc.

(iv) Diversion of Resources for Reducing Regional Disparities. Diversion of resources from the private to public is essential for reducing regional disparities. For example, Rajasthan, Bihar and the eastern Uttar Pradesh in particular are considered to be the most underdeveloped and backward areas in our country. Public expenditure can be effectively used for reducing regional disparities by means of establishing labour intensive and subsidized industries, providing basic facilities like water, electricity, cheap finance, technical know-how, spread of technical education, cheap loans and advances and developing employment opportunities etc.

(v) Diversion of Resources for Economic Growth and Maintenance of Economic Stability. Diversion of resources from private to public are essential for rapid economic growth and the maintenance of economic stability - full employment and price stability. Public expenditure can help private investment and production through measures which reduce cost of production, push up demand or remove particular shortages and bottlenecks. Creation and maintenance of social overheads would lead to an all-round reduction in cost of production and improvement in efficiency. This, therefore, increases profitability and production. Also social overheads bring different regions and sectors of an economy to dose contact and thereby stimulate economic growth.

(II) Effects of public Expenditure on Distribution . Public expenditure has its effects not only on production but is also a most powerful weapon in the hands of the government for bringing about an equitable distribution of wealth and national income. For bringing about an equitable and just distribution of wealth. The government can use not only its taxation policy but public expenditure policy also help great extent achieving very objective. fact, the role public expenditure in removing inequalities income complementary and supplementary. If the government intends to minimise economic inequalities that exist the society, levy maximum amount taxation the community, because taxable capacity undoubtedly high.The income so earned through taxation should be spent on providing various types facilities, subsidies and amenities to the poorer sections of the community.

(III) Effects of Public Expenditure on Consumption Public expenditure also affects Due to public expenditure the size of consumption tends to increase in the economy. Since public expenditure tends redistribute the income favour of poor people and their marginal propensity to consume being high, the overall impact public expenditure leads rapid increase the consumption the economy.

(IV) Miscellaneous Effects of Public Expenditure

(i) Effect of Public Expenditure on Economic Stability. It is an admitted fact that public expenditure has proved to be powerful tool for bringing about economic stability in the country. It excellent instrument for regulating and controlling volume of employment in country. The government should make substantial increase public expenditure at time of depression, because this will help bring about an automatic increase in the volume of employment.

(**ii) Effect of Public Expenditure en Economic Growth.** There is close relationship between public expenditure and economic growth. A rising proportion of additional output should be developed to capital formation, so that the economic growth of an undeveloped country may be speeded up.

(iii) Effects of Public Expenditure on Employment. Public expenditure programmes may directly help to provide employment to several individuals and by increasing these people demand for goods and services, it may further increase employment opportunities, as the increase in demand will lead to greater production and thereby provide employment to an army of unemployed persons.

CAUSES OF GROWTH OF PUBLIC EXPENDITURE

FACTORS RESPONSIBLE FOR THE GROWTH OF PUBLIC EXPENDITURE

There are number of factors responsible for the Growth of Public Expenditure, but the most important factor are as under:

1. Establishment of Welfare States: The modern state is a welfare state. It aims at promoting the economic, political and social well-being of citizens. It makes every effort to improve the living standard of common people. For this purpose, it has to undertake many functions and services never visualized before. Even in an avowed capitalistic economy, there has been increasing state intervention, through legislative and administrative measures, for augmenting production and improving distribution. Many wants which were formerly satisfied individually by private means are now satisfied collectively through public expenditure.

2. The Need for Defence: Due to the invention of nuclear weapons there is always a danger of foreign aggression. International political situation is uncertain and insecure. Modern states are already facing a cold war. As such, every nation has to prepare itself for a strong defence. The defence expenditure is thus perpetually rising. It contains expenditure on war materials, maintenance and growth of armed forces, naval and air wing, expenses on development of military art and practice, pensions to retired war personnel, interest on war loans obtained in the past or present rehabilitation cost of war. etc. Expenditure on defence in India has risen from 3278 crore in 1980-81 to 1,37,359 crore in 2015-16.

3. The Role of Democracy and Socialism: The recent grow of democracy and socialism everywhere in the world has caused public expenditure to increase very much. A democratic structure of government is inevitably more expensive that a totalitarian government. In India, democracy has certainly be-become a costly affair. Expenditure on elections and by-elections is increasing. Number of ministries and executive offices has also been increased. Further, the ruling party has to fulfil its promises and launch upon new policies and programmes to achieve socialist objectives, atleast to persuade public operation in its favour. This also requires increasing state expenses in order to provide new amenities and opportunities to the people at large.

4. The Urbanization Effect: The spread of urbanization is an important factor leading to the relative growth of public expenditure in modern times. With, the growth of urban areas, there has been an increasing tendency of expenditure on civil administration. Expenses on water supply, electricity, provision of transport, maintenance of roads, schools and colleges, traffic controls, public health, parks and libraries, play grounds, etc. have increased enormously in these days. Likewise, the expenditure on courts, prisons etc. is increasing, especially in the urban sector.

5. The Rural Development Effect: In an underdeveloped country, the government has also to spend more and more for rural development. It has to undertake schemes like community development projects and other social measures.

6. The Population Effect: Since independence the percentage of urban population has increased in the country as against 17.3% in 1951 it increased to 31.2% as per census 2011. The secular growth of population naturally calls for increase in public expenses as all state functions are to be performed more extensively. Rising population also poses various problems in poor countries. The state will have the added responsibility of solving such problems as food. Unemployment, housing and sanitation. Further, over-populated countries like India will have to check the population growth. The state has, therefore, to spend more and more on family planning campaigns every years.

7. The Growth of Transport and Communication: With the expansion of trade and commerce, the state has to provide and maintain a quick and efficient transport system. Transport being a public utility, the state has to provide it cheaply also. Hence, railway and passenger transport is nationalized. Government has, therefore, to run transport services even at a loss. This obviously calls for a high expenditure for maintenance and expansion.

8 The Planning Effect: In a less developed economy, the government adopts economic planning for the development of the country. In a planned economy, thus, when the public sector is expanding its role, the public expenditure obviously shows an increasing trend.

9. Increase in Social Securities: Almost all the countries of world have started to provide to the workers and other residents social securities, such as, Social Insurance, Provident Fund Scheme, Compensation for injury, Pension, Unemployment Allowance, Maternity Benefits, etc. This, too, has caused an increase in the government expenditure.

10. Rise in Price Level: Owing to price rise, the government has had to pay dearness allowance to its employees, besides revising their salaries periodically. The expenditure of the development projects of the government has also gone up. Since 1975, rise in the price of petroleum has also led to an increase in the Public expenditure of petroleum importing countries like India which imports 80% of its fuel which adds fire on public expenditure India has inelastic demand of petroleum products.

11. Influence of International Organizations: For the last several years, some international organizations such as, International Labour Organization, World Health Organization, U.N.O., etc., too are responsible for increasing the expenditure of various governments. Also, it is incumbent on the governments to have their embassies in the foreign countries to maintain diplomatic relations.

CONTROL AND ACCOUNTABILITY OF PUBLIC EXPENDITURE

INTRODUCTION

On account of growing burden of non-development expenditure, the fiscal situation deteriorated throughout the 1980s and assumed crisis proportions by the beginning of 1991-92. Throughout the 1980s, all the indicators of fiscal imbalance clearly reflected that it was on the rise. The indictors which are often considered to asses the fiscal imbalance are the revenue deficit and the gross fiscal deficit. The revenue deficit refers to the difference between revenue receipts and revenue expenditure. This measure of fiscal imbalance does not completely, reflect the structural imbalance in the fiscal operations of the government. The fiscal deficit reflects the total resource gap which equals the excess of total government expenditure over government revenue and grants.

PUBLIC EXPENDITURE MANAGEMENT

An important justification for expenditure management in the period since 1991 (known as the period of economic reforms) was that the fiscal deficit must be reduced since it was considered to a source of instability for the economy. The policymakers relied on three arguments to cut down gross fiscal deficit of the Central government which was as high as 7.55 per cent of GDP during 1985-90. Over this period, the revenue deficit was also as large as 2.37 per cent of GDP. First, the government assuming that a fiscal deficit in inherently problematic argued that it can be inflationary or may cause external deficits. Second, it asserted that large fiscal deficits will reduce more desirable private investment by reducing the availability of investigable resources and raising the interest rate on borrowing.

Reduction of Public Expenditure to GDP

In an inflationary economy, public expenditure in absolute term cannot be reduced. Hence, the government did not aim at it. The government nevertheless sought to curtail general expenditure. Issues of allocative and technical efficiency in the design and implementation of public expenditure received scant attention. While there was virtually no attempt to curb extravagance on the part of ministers and bureaucrats development expenditure was drastically curtailed. In totality, the expenditure policy of the government lacked both rationality and direction and thus the ratio of public expenditure to GDP was 28.6 per cent in 2009-10, almost the same as in 1990-91. From 1991-92 for seven years, the ratio of public expenditure to GDP registered a modest decline. In 1997-98 this ratio had fallen to 25.0 per cent. Thereafter, the trend was reversed as the ratio of public expenditure to GDP rose to 28.0 per cent in 2000-01 and further to 29.0 per cent in 2015-16. Budget estimate of public expenditure to GDP ratio in 2016-17 is 29.3 per cent.

Reduction in Capital Expenditure - GDP Ratio

The main problem by the end of 1990s was that while revenue expenditure - GDP ratio stagnated around 13 per cent, there was a steep reduction in capital expenditure - GDP ratio.

Thereafter, it steadily increased and stood at 12.3 per cent in 1999. 2000. Therefore, as far as revenue expenditure GDP ratio is concerned. by the end of the 1990s the government was exactly where it was in 1990-91. In this decade, the interest payments - GDP ratio steadily rose from 3.8 per cent in 1990-91 to 4.6 per cent in 1999-2000. Therefore, ratio of net revenue expenditure to GDP declined only to the extent the interest payments - GDP ratio rose during the 1990s. The reduction in capital expenditure - GDP ratio, however, is strikingly large in period. The capital expenditure -GDP ratio was 5.6 per cent in 1990-91. It declined steadily throughout thereafter and stood at only 2.5 per cent in 1999-2000 and 1.8 per cent in 2016-17. It is thus that the burden of fiscal imbalance correction during the period of economic reforms has been primarily on capital expenditure. Stagnant revenues on the one hand and sharply increasing subsidies and transfers on the other hand. have crowded out capital expenditures. Thus, as alleged by M. Govind Rao, the political dynamics has resulted in capital expenditure being taken as a residual. This approach of the Central government is questionable. Reducing expenditure on transport and infrastructure development both in urban and rural areas has disrupted the growth Reduced capital expenditure in real terms over the years has become such a constraint that it unreservedly dampens investment activity in the private sector. This has caused a setback to overall growth process particularly at a time when the State has dramatically withdrawn from directly productive activity.

Reduction of Subsidies

Direct subsidies on food, fertilizer, and export which accounted for 2.2 per cent of GDP in 1990-91, declined to 1.3 per cent in 1996-97 and fluctuated around that level during the last five years of the decade. Subsidies accounted for 1.4 per cent of GDP in 2007-08 and 1.7 per cent of GDP in 2016-17. The export subsidies were eliminated by 1992. The government thus aimed at reducing food and fertilizer subsidies. Food subsidies were cut through increases in prices of foodgrains issued through the public distribution system. This policy denied access to food to many poor households and thus involved heavy social cost. Accordingly, the government has started providing foodgrains to the people below poverty line at highly subsidized rates under Targeted Public Distribution System. As a result, the burden of food subsidy has increased. Fertiliser subsidies which accrue directly to the fertilizer industry were also sought to be cut. Since reduction in fertilizer subsidy entailed rising prices faced by the farmers, the use of fertilizers remained restricted arresting growth of agriculture production.

Interaceable interest payment

Interest payments have been the single largest component of the revenue expenditure and are the result of past borrowings. Interest payments were sought to be reduced by reducing a part of the public debt. But the performance of the government on this front has been dismal. Interest payments as a proportion of GDP rose from an average of 3.2 per cent during 1985-90 to an average of 4.1 per cent during 1990-95 and climbed to 4.7 per cent in 2000-01. In 2016-17, they were 3.2 per cent of GDP. Interest payments are estimated to have absorbed 44.4 per cent of tax receipts in 2016-17.

UNIT - 3 : TAXATION

MEANING OF PUBLIC REVENUE

The income of the government through all sources is called public income or public revenue. According to Dalton, however, the term "Public Income" has two senses-wide and narrow. In its wider sense it includes all the incomes or receipts which a public authority may secure during any period of time. In its narrow sense, however, it includes only those sources of income of the public authority which are ordinarily known as "revenue resources." To avoid ambiguity, thus, the former is termed "public receipts" and the latter "public revenue." As such, receipts from public borrowings (or public debt) and from the sale of public assets are mainly excluded from public revenue. For instance, the budget of the Government of India is classified into "revenue" and "capital.""Heads of Revenue" include the heads of income under the revenue budget, whereas the heads of income under the capital budget are termed as "receipts". Thus, the term "receipts" includes sources of public income which are included from "revenue".

SOURCES OF PUBLIC REVENUE

In a modern welfare state, public revenue is of two types, tax revenue and non tax revenue.

Tax Revenue

A fund raised through the various taxes is referred to as tax revenue. Taxes are compulsory payment imposed by the government on its citizens to meet its general expenses incurred for the common good. without any corresponding direct benefits to the taxpayer. As Taussig puts it, "the essence of a tax, as distinguished from other charges by government, is the absence of a direct quid pro quo between the tax payer and the public authority."

Seligman defines a tax thus: "A tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all, without reference to special benefits conferred.

Non Tax Revenue

Public income received through the administration, commercial enterprises, gifts and grants are the source of non-tax revenues to the government. Thus,, non-tax revenue include:

(i) Administrative revenues;

(ii) Profit from state enterprises; and

(iii) Gifts and grants.

Administrative Revenues

Under public administration, public authorities can raise some funds in the form of fees, fines and penalties, and special assessments, Fees. Fees are charged by the government or public authorities for rendering a service to the beneficiaries. To quote Seligman, A fee is a payment to defray the cost of each recurring service undertaken by the government, primarily in the public interest, but conferring a measurable advantage to the "payer." Court fees, passport fees, etc., fall under this category. Similarly, licence fees are charged to confer a permission for something by the controlling authority e.g., driving licence fee, import licence fee, liquor permit fee, etc. Fees are to be paid by those who receive some special advantages. Generally the amount of the fee depends upon the cost of services rendered. Fees are a bye product of the administrative activities of the government and not a payment for a business. Thus, fees are distinct from prices. Prices are always voluntary payments, but fees are compulsory contributions, through both are made for special services. Sometimes a fee contains an element of tax when it is charged high in order to bring revenue to the exchequer e.g., a licence fee.

Fines and Penalties.

Fines and penalties are levied and collected from offenders of laws as punishment. Here the main object of these levies is not so much to earn an income as to prevent the commission of offences and infringement of laws of the country. Fines and penalties are arbitrarily determined and have no relation to the cost of administration or activities of the government. Hence, collections from such levies are insignificant as a source of public revenue.

Special Assessments.

"A special assessment," as Seligman points out. "is a compulsory contribution levied in proportion to the social benefits derived to defray the cost or a specific improvement to property undertaken in the public interest." That is to say, sometimes when the government undertakes certain types of public improvements such as construction of roads, provision of drainage, street-lighting, etc., it may coafer a special benefit to those possessing properties nearby. As a result, values or rents of these properties may rise. The government, therefore, may impose some special levy to recover a part of the expenses so incurred. Such special assessment is levied generally in proportion to the increase in the value is levied generally in proportion to the increased in the value of the properties involved. In this respect, is differs from a tax..

In India, these special assessments are referred to as "betterment levy." Betterment levy is imposed on land when its value is enhanced by the construction of social overhead capital such as roads, drainage, street-lighting, etc. by the public authority in an area. **Profits of State Enterprise**

Profits of state undertakings also are an important source of revenue these days, owing to the expansion of the public sector. For instance, the Central Government runs railways. Surplus from railways earnings can be normally contributed to the revenue budget of the Central Budget. Likewise, profits from the state transport corporation and other public undertakings can be an important source of revenue for the budgets of State Governments. Similarly, other commercial undertakings in the public sector such as Hindustan Machine Tools, Bokaro Steel Plant, State Trading Corporation, etc. can make profits to support the central budget.

Earnings from state enterprises depend upon the prices charged by them for their goods and services and the surplus derived there from. Thus, the pricing policy of state undertakings should be self-supporting and reasonably profit-oriented. Again, prices are charged with an element of quid pro quo i.e., directly in proportion to the benefits conferred by the services rendered.

A price is a form of revenue derived by the government by selling goods and services of public enterprises. Thus, price is the revenue obtained from business activity undertaken by the public authorities.

Many pubic enterprises like postal services run a cost-to-cost basis. The prices are charged just to cover the cost of rendering such services. However, in certain cases, when the state has an absolute monopoly profits of a state enterprise are in the nature of a tax. The difference between price and fee is this: the former usually can never be less than the cost of production or service, while the latter may not necessarily cover the cost of service.

Gifts and Grants

These form generally a very small part of public revenue. Quite often, patriotic people or institutions may make gifts to the state. These are purely voluntary contributions. Gifts have some significance, specially during war time or an emergency.

In modern times, however, grants from one government to another has a greater importance. Local governments receive grants from state governments and state government from the centre. The Central Government gives grants in-aid to state governments in order to enable them to carry out their functions. When grants are made by one country's government to another country's government it is called foreign aid. Usually poor countries receive such aid from developed countries, which may be in the form of military aid, economic aid, food aid, technological aid, and so on.

TAXATION: MEANING AND CLASSIFICATION

MEANING OF A TAX

A tax is a compulsory payment. It has to be paid by the person on whom it is levied. A person cannot argue as he is not getting any direct benefit so he will not pay the tax. It must be spent on general welfare after it has been collected, e.g. a municipal committee will spend on water, road, electricity after collecting the house and property taxes.

According to Bastable, "Tax is a compulsory contribution of the wealth of a person or body of persons for the service of the pubic powers."

In the words of Seligman, "Tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all, without references to special benefits conferred."

According to Dalton, "A tax is a compulsory contribution imposed by a public authority, irrespective of the exact amount of service rendered to the tax-payer in return."

CLASSIFICATION OF TAXATION

Different economists have classified taxes in different ways. This does not mean that one classification contradicts the other. The classifications have been made on different basis. Different basis which have been adopted by different economists to classify taxes are the forms, nature, aims and methods of taxation. The following classifica tions are commonly found in the modern tax system:

I. Direct and Indirect Taxes.

II. Proportional, Progressive, Regressive and Degressive Taxes.

III. Specific and Ad Valorem Duties/Taxes.

IV. Single and Multiple Taxes.

I. **Direct and Indirect Taxes**

Meaning of Direct Taxes. A direct tax is that whose burden is borne by the person on whom it is levied. He cannot transfer the burden. of the tax to some other person. For example, the income tax is a direct tax and its burden falls on the person who pays it to the government. According to Dalton, "A direct tax is really paid by the person on whom it is legally imposed...... "

According to J.S. Mill, A direct tax is one which is demanded from the person who intended or desired should pay ..... " According to this definition, personal income tax or property tax is a direct tax since there would be no shifting of the burden.

According to Prof. Findlay Shirras, "Those levied immediately on property and income of persons and those paid by the consumers to the state direct are called direct taxes."

Indirect Taxes

Meaning of Indirect Taxes. An indirect tax is that which is paid by one individual but the burden of which is borne by another) individual. A person who pays the tax in the first instance transfer its burden to the shoulders of another person. For example, the excise duty on sugar is paid in the first instance by the producer, but ultimately he transfers the burden of this duty to the purchaser in the form of higher. price for sugar.

According to Hartley, "Taxes which are shifted quickly through commercial competition between consumers are indirect taxes. According to Prof. Findlay Shirras, "Which affect the income and property of persons through their consumption may be called as indirect taxes."

II. Proportional, Progressive, Regressive and Degressive Taxes

The methods of taxation may be proportional, progressive, regressive and degressive. A tax system may be composed of different kinds of taxes, such as, proportional, progressive, regressive or degressive. They are explained as under:

Proportional Taxes

A progressive tax system is a tax that imposes a lower tax rate on low income earners compared to those with high income. This type of tax is based on the ability to pay of the tax payers.

In other words a tax on all incomes is levied at the same rate, it is called proportional tax. A schedule of proportional tax rates is one in which the rates of taxation remain constant as the tax base changes. The amount of tax is calculated by multiplying the tax base with the tax rate. In this case the tax liability increases in the same proportion as the increase in income that is why it is called as proportional tax.

Progressive Tax

A tax, the rate of which increases with every increase in income is called progressive tax. A schedule of progressive tax rate is one in which the rate of taxation increases as the tax base increases. In India, we have progressive tax rate system.

Regressive Tax

In regressive taxation, the larger the income of tax-payer, the smaller is the proportion that he contributes. A schedule of regressive tax rate is one in which the rate of taxation decreases as the base increases. The amount of tax payable is calculated by multiplying the tax base with the tax rate. Thus, in regressive tax system, the tax rate decreases as the income increases, though the amount of money paid by way of tax increases with the increase of income.

Degressive Tax

A degressive tax is one on which tax is progressive up to a certain limit, after that it is proportional, i.e., charged at flat rate.

III. Specific and Ad Valorem Duties / Taxes

When a tax is imposed on a commodity according to its weight, size or measurement, it is called a specific tax. For example, when the excise duty is imposed on sugar on the basis of its weight or the cloth is taxed according to its length, it is known as a specific tax. It is easy to levy and more convenient to collect because it is collected either according to the weight of the commodity or the size of the unit of the commodity. On the other hand ad valoren is tax based on assessed value of an item such a real estate or personal property. It is also imposed as import duty on goods from abroad.

IV. Single and Multiple Taxes

Single Tax : A single tax means only one kind of tax. It implies a tax on one Xthing, that is, on one class of things or on one class of people. In this as case, there is only one tax which constitutes the source of public revenue. Such a tax is collected not only once but regularly every month or every year, at intervals of shorter or longer duration.

Multiple Tax: Multiple tax system simply implies that there should be different he types of taxes so that everybody may be called upon to contribute something towards the state revenue. Hence, a multiple tax system is generally preferred to a single tax system. However, too great a multiplicity would be undesirable because it would involve a large cost of collection.

CANONS, CHARACTERISTICS & FACTORS DETERMINING TAXATION CAPACITY

CANONS OF TAXATION

A good tax system should have a proper combination of all kinds of taxes having different canons or the principles on which they are imposed.

According to Adam Smith, there are four canons of maxims of taxation on the administrative side of public finance which are still recognised as classic. To him a, good tax is one which contains:

(1) Canon of equality.

(2) Canon of certainty.

(3) Canon of economy.

(4) Canon of convenience.

To these four canons, economists like Bastable have added a few more which are as under:

(5) Canon of elasticity.

(6) Canon of productivity.

(7) Canon of simplicity.

(8) Canon of diversity.

(9) Canon of expediency.

Now let us discuss the above mentioned canons of taxation in detail:

Canon of Equality

The canon of equality or equity implies that the burden of taxation must be distributed equally or equitably in according to the ability of the tax-payers. Equality of social justice demands that the rich people should bear a heavier burden of tax and the poor a lesser burden. Hence, a tax system should contain progressive tax rates based on the tax-payer's ability to pay and sacrifice, this is the most applicable and important canon of a tax system

Canon of Certainty

Taxation must have an element of certainty. According to Adam Smith, "the tax which each individual is bound to pay must to be certain and non arbitrary. The time of payment, the method of payment, the amount to be paid ought to be clear and plain to the contributor and to every other person." Canon of certainty is also on integral and an important part of any goods tax system.

Canon of Economy

According, to Adam 'Smith, "Every tax has to be contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state." Owing to the complex and ever changing nature of taxation laws in India, government has to maintain an elaborate tax collection machinery with a large staff of highly trained personnel involving low administrative costs and should avoid delay in assessment and collection of tax, so that the basic purpose of the tax collection served.

Canon of Convenience

Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it. It is convenient to pay a tax when it is deducted at source from the salaried classes at the time of paying salaries or at the time of harvesting from the farmer.

Canon of Elasticity

Taxation should be elastic in nature in the sense that more revenue is automatically fetched when income of the people rises. This means that taxation must have built-in flexibility, so at the time of any emergency or need more revenue can be raised easily.

Canon of Productivity

This implies that a tax must yield sufficient revenue and not adversely affect production in the economy, it should enhances the productive capacity of the nation.

Canon of Simplicity

This implies that tax rates and tax systems ought to be simple and comprehensible and not to be complex and beyond the understanding of a layman.

Canon of Diversity

This implies that there should be a multiple tax system of diverse nature rather than having a single tax system. In the former case, the tax payer will not be burdened with a high incidence of tax in the aggregate.

Canon of Expediency

This implies that a tax should be determined on the ground of its economic, social and political expediency. For instance, a tax on agricultural income lacks social, political or administrative expediency in India and that is why the government of India had to discontinue it.

CHARACTERISTICS OF A GOOD TAX SYSTEM

A sincere effort has been made to include the good characteristics of a tax system. The following are the good characteristics of Indian tax structure or any other tax system

(1) Multiplicity of Taxes

The main characteristic of Indian tax structure is the multiplicity of taxes. Almost all kinds of taxes have been imposed in India, such as, income tax, wealth tax, gift tax, capital gains tax, death duty etc.

(2) Based on Fundamental Principles.

Indian tax structure is said to be based on fundamental principles of taxation. Almost all the principles have been included in the Indian tax structure from the very beginning till date the efforts are being made constantly to incorporate the principles / canons which are part and parcel of a good tax system.

(3) Dominance of Indirect Taxes.

There is dominance of indirect taxes as against direct taxes in Indian tax structure, It is estimated that more than 85% of taxes are collected through indirect taxes as against only 15% revenue from direct taxes.

(4) Maximum Social Benefit.

While devising Indian taxation policy, Government of India keeps in mind the objective of achieving maximum social benefit. Indian taxation system is said to be used as an instrument of attaining certain social objectives, e.g., as a means of removing inequality of income, diverting resources for productive purposes and thereby increasing the social welfare of the community.

(5) Higher Burden of Taxes on Urban Areas as Compared to Rural Areas.

Agriculture is the main source of income in rural areas and agricultural income is exempted in India. Hence, there is higher burden of taxes on urban areas as compared to rural areas. Recently, Indian Taxation Enquiry Committee has admitted in its report, "The burden on urban households was distinctly higher than on the rural households in the corresponding expenditure class".

MAJOR TRENDS IN TAX REVENUE

MAJOR TRENDS IN TAX REVENUE OF CENTRAL & STATE GOVERNMENT OF INDIA

Tax revenue of central government

The total tax revenue of the Central government in 1970-71 was ₹2,451 crore. Of this, the share of direct taxes was ₹511 crore (i.e., 20.8 per cent) while the share of indirect taxes was ₹1,940 crore (i.e., 79.2 per cent).

This shows that only one-fifth of the tax revenue was contributed by direct taxes. The share of direct taxes fell further 16.1 per cent in 1990-91. however, on account of recent tax reforms, the share of direct taxes in total tax revenue has increased it was 36.3 per cent in 2000-01) and 59.5 per cent in 2009-10. In 2016-17, direct taxes contributed ₹5,26,153 crore which was 48.3 per cent of the total tax revenue of ₹10,88,793 crore.

DIRECT AND INDIRECT TAXES OF CENTRAL GOVERNMENT

1. The share of personal income tax in total direct tax revenue was 22.3 per cent in 1970-71 (₹114 crore out of ₹ 511 crore). It fell to 18.1 per cent in 1990-91 but rose to as high as 46.3 per cent in 2001-02. in 2016-17, the share of personal income tax in total direct tax revenue was 40.9 per cent (₹2,15,016 crore out of ₹5,26,153 crore). The share of corporation tax in total direct tax

revenue was 72.6 per cent in 1970-71 (₹371 crore out of ₹ 511 crore) and 59.1 per cent in 2016-17 (₹3,11,131 crore out of ₹5,26,153 crore).

2. Of the total indirect tax revenue of ₹ 1,940 crore in 1970-71, excise duties contributed ₹ 1,369 crore which comes to 70.6 percent. Their share fell to only 39.1 per cent in 1990-91 but rose subsequently to 57.2 per cent in 2000-01 and further to as high as 63.6 per cent in 2003-04. However, it fell thereafter and stood at 52.2 per cent in 2016-17 (₹ 2,93,824 crore out of ₹5,62,639 crore). This was due to economic slowdown in the economy during the year 2008-09 which had a negative impact on corporate activity.

3. Customs duties accounted for 27.0 per cent of indirect tax revenue in 1970-71 (₹524 crore out of ₹1,940 crore). Their share in indirect tax revenue rose to 57.2 per cent in 1990-91 and 59.9 per cent in 1995-96. However, the share of customs duties in total indirect tax revenue was only 23.6 per cent in 2016-17 (₹1,32,933 crore out of ₹5,62,639 crore). The relative decline in customs duties in recent years is due to substantial reductions in duty rates.

4. The relative share of personal income tax, corporation tax, excise duties and customs duties in total tax revenue in 1970-71 was 4.6 per cent, 151.1 per cent, 55.8 per cent and 21.4 per cent respectively. Thus, more than half of the tax revenue was contributed by excise duties. Considerable changes in the relative contribution of these taxes took place over the years. For instance, the relative shares of these taxes in total tax revenue in 1990-91 were 2.9 per cent, 12.4 per cent, 32.8 per cent and 48.0 per cent respectively. This shows that customs duties became the most important source of tax revenue in 1990-91. However as the process of import liberalisation gathered momentum in the post-economic reform period and, as a result, import duties were slashed, the share of customs duties in total tax receipts has tended to decline. In 2016-17 the relative shares of taxes in total tax revenue was as follows- personal income tax 19.7 per cent, corporation tax 28.6 per cent, excise duties 27.0 per cent and customs duties 12.2 per cent. Thus, the most important contributor to tax revenue now is the corporation tax. This is mainly due to the rising incomes of the corporate sector in recent years following economic liberalisation.

TAX REVENUE OF THE STATE GOVERNMENTS

The principal tax revenue sources of the State governments over the years have bee the share of the States in the Central taxes and duties, commercial taxes, land revenue, stamp duties and registration fees, and the State excise duties on alcohol and other narcotics. Of all commercial taxes, sales tax has been the most important. However, this tax was later replaced by Value Added Tax (VAT). Taxes on motor spirit and vehicles, entertainment tax and duties on electricity were other commercial taxes. For a long time, land revenue was an important source of revenue of the States. Until the beginning of the World War II States raised nearly 35 per cent of the revenue from this source Thereafter, its important considerably decline. Land revenue by its nature is an inelastic tax and thus over the years revenue proceeds from this source did not increase much. Thus, its contribution to States' tax revenue declined from 9 per cent in 1967-68 to 0.8 per cent in 2006-07 Due to stress on prohibition in the country, the revenue collection from the excise duty on alcoholic liquors and narcotics did not increase to the maximum possible level. In 2015-16, State excise duties accounted for 7.6 per cent of the total tax revenue of the States. Reliance of the States on sales tax had considerably increased over the years. In 2015-16, State excise duties accounted for 7.6 per cent of the total tax revenue of the States. Reliance of the States on Sales tax had considerably increased over the years. in 2015-16, this tax had accounted for 40.0 per cent the State governments' tax revenue (₹5,61,701 crore out of ₹14,07,779 crore). The share of States in Central taxes in 2015-16 was ₹5,16,766 crore (which was 36.7 per cent of the total tax revenue of the States). In other words, sales tax and share of States in Central taxes together accounted for 76.7 per cent (i.e., more than three-fourths) of the total tax revenue of the States in 2015-16.

The government introduced the Goods and Services Tax (GST) from July 1, 2017 which has subsumed all the indirect taxes imposed by Central and States. Thus, from 2017-18 onwards, discussion of sources of tax revenue of Centre and States will change drastically.

GOODS AND SERVICE TAX

MEANING OF GST

Goods and Service Tax (GST) is an Indirect Tax which has replaced many Indirect Taxes in India. The Goods and Service Tax Act was passed in the Parliament on 29th March 2017. The Act came into effect on 1st July 2017; Goods & Services Tax Law in India is a comprehensive, multi-stage, destination-based tax that is levied on every value addition.

In simple words, Goods and Service Tax (GST) is an indirect tax levied on the supply of goods and services. This law has replaced many indirect tax laws that previously existed in India.

GST is one indirect tax for the entire country.

Under the GST regime, the tax will be levied at every point of sale. In case of intra-state sales, Central GST and State GST will be charged. Inter-state sules will be chargeable to Integrated GST or IGST.

"GST is a comprehensive, multi-stage, destination-based tax that will be levied on every value addition." In existing tax system which was mired in multi layered taxes levied both by centre and state governments at different stages of supply chain such as excise duty, octroi, Central Sales Tax (CST) and value added tax, among others.

In GST, all these indirect taxes were subsumed under single regimes. The system has changed from the previous production based the Taxation to the current consumption based taxation. GST is the biggest ever indirect tax reform since independence.

FEATURES OF GST

The following are salient features of GST

(i) GST would be applicable on "supply" of goods or services as against the present concept of tax on the manufacture of goods or on sale of goods or on provision of services.

(ii) GST would be based on the principle of destination based consumption taxation as against the present principle of origin-based production taxation.

(iii) It would be a dual GST with the Centre and the States simultaneously levying it on a common base. The GST to be levied by the Centre would be called Central GST (central tax- CGST) and that to be levied by the States [including Union territories with legislature] would be called State GST (state tax- SGST). Union territories without legislature would levy Union territory GST (union territory tax- UTGST).

(iv) An Integrated GST would be levied on inter-State supply (including stock transfers) of goods or services. This would be collected by the Centre so that the credit chain is not disrupted.

(v) Import of goods would be treated as inter-State supplies and would be subject to IGST in addition to the applicable customs duties.

(vi) Import of services would be treated as inter-State supplies and would be subject to IGST.

(vii) CGST, SGST /UTGST& IGST would be levied at rates to be mutually agreed upon by the Centre and the States under the aegis of the GSTC.

(viii) GST would replace the following taxes currently levied and collected by the Centre: Page 5 of 11

(a) Central Excise Duty:

(b) Duties of Excise (Medicinal and Toilet Preparations);

(c) Additional Duties of Excise (Goods of Special Importance);

(d) Additional Duties of Excise (Textiles and Textile Products);

(e) Additional Duties of Customs (commonly known as CVD);

(f) Special Additional Duty of Customs (SAD);

(g) Service Tax;

(h) Cesses and surcharges insofar as they relate to supply of goods or services

(ix). State taxes that would be subsumed within the GST are:

(a) State VAT;

(b) Central Sales Tax;

(c) Purchase Tax;

(d) Luxury Tax;

(e) Entry Tax (All forms);

(f) Entertainment Tax (except those levied by the local bodies);

(g) Taxes on advertisements;

(h) Taxes on lotteries, betting and gambling;

(i) State cesses and surcharges insofar as they relate to. supply of goods or services.

(x) GST would apply to all goods and services except Alcohol for human consumption.

(xi) GST on five specified petroleum products (Crude, Petrol, Diesel, ATF & Natural gas) would be applicable from a date to be recommended by the GST, council.

(xii) Tobacco and tobacco products would be subject to GST. In addition, the Centre would continue to levy Central Excise duty.

(xiii) A common threshold exemption would apply to both CGST and SGST. Taxpayers with an annual turnover of Rs. 20 lakh (Rs. 10 lakh for special category States (except J&K) as specified in article 279A of the Constitution) would be exempt from GST. A compounding option (i.e. to pay tax at a flat rate without credits) would be available to small taxpayers (including to manufacturers other than specified category of manufacturers and service providers) having an annual turnover of up to Rs. 75 lakh (Rs. 50 lakh for special category States (except J&K and Uttarakhand) enumerated in article 279A of the Constitution). The threshold exemption and compounding scheme would be optional. Page 6 of 11.

(xiv) The list of exempted goods and services would be kept to a minimum and it would be harmonized for the Centre and the States as well as across States as far as possible.

(xv) All Exports and supplies to SEZS and SEZ units would be zero-rated.

(xvi) Credit of CGST paid on inputs may be used only for paying CGST on the output and the credit of SGST/UTGST paid on inputs may be used only for paying SGST/UTGST. In other words, the two streams of input tax credit (ITC) cannot be cross utilized, except in specified circumstances of inter-State supplies for payment of IGST.

The credit would be permitted to be utilized in the following manner:

(a) ITC of CGST allowed for payment of CGST & IGST in that order;

(b) ITC of SGST allowed for payment of SGST & IGSTin that order;

(c) ITC of UTGST allowed for payment of UTGST & IGST in that order;

(d) ITC of IGST allowed for payment of IGST, CGST & SGST/UTGST in that order. ITC of CGST cannot be used for payment of SGST/UTGST and vice versa.

(xvii) Accounts would be settled periodically between the Centre and the State to ensure that the credit of SGST used for payment of IGST is transferred by the originating State to the Centre. Similarly the IGST used for payment of SGST would be transferred by Centre to the destination State. Further the SGST portion of IGST collected on B2C supplies would also be transferred by Centre to the destination State. The transfer of funds would be carried out on the basis of information contained in the returns filed by the taxpayers.

(xviii) Input Tax Credit (ITC) to be broad based by making it available in respect of taxes paid on any supply of goods or services or both used or intended to be used in the course or furtherance of business.

(xix) Electronic filing of returns by different class of persons at different cut-off dates.

(xx) Various modes of payment of tax available to the taxpayer including internet banking, debit/ credit card and National Electronic Funds Transfer (NEFT) Real Time Gross Settlement (RTGS).

(xxi) Obligation on certain persons including government departments, local authorities and government agencies, who are recipients of supply, to deduct tax at the rate of 1% from the payment made or credited to the supplier where total value of supply, under a contract, exceeds two lakh and fifty thousand rupees.

(xxii) Refund of tax to be sought by taxpayer or by any otherperson who has borne the incidence of tax within two years from the relevant date.

(xxiii) Obligation on electronic commerce operators to collect 'tax at source', at such rate not exceeding two per cent. (2%) of net value of taxable supplies, out of payments to suppliers supplying goods or services through their portals. The provision for TCS has not been notified yet.

(xxiv) System of self-assessment of the taxes payable by the registered person.

(xxv) Audit of registered persons to be conducted in order to verify compliance with the provisions of Act.

(xxvi) Limitation period for raising demand is three (3) years from the due date of filing of annual return or from the date of erroneous refund for raising demand for short-payment or non-payment of tax or erroneous refund and its adjudication in normal cases.

(xxvii) Limitation period for raising demand is five (5) years from the due date of filing of annual return or from the date of erroneous refund for raising demand for short-payment or non-payment of tax or erroneous refund and its adjudication in case of fraud, suppression or willful mis statement.

(xxviii) Arrears of tax to be recovered using various modes including detaining and sale of goods, movable and immovable property of defaulting taxable person.

(xxix) Goods and Services Tax Appellate Tribunal would be constituted by the Central Government for hearing appeals against the orders passed by the Appellate Authority or the Revisional Authority. States would adopt the provisions relating to Tribunal in respective SGST Act.

(xxx) Provision for penalties for contravention of the provision of the proposed legislation has been made.

(xxxi) Advance Ruling Authority would be constituted by States in order to enable the taxpayer to seek a binding clarity on taxation matters from the department. Centre would adopt such authority under CGST Act.

(xxxii) An anti-profiteering clause has been provided in order to ensure that business passes on the benefit of reduced tax incidence on goods or services or both to the consumers.

(xxxiii) Elaborate transitional provisions have been provided for smooth transition of existing taxpayers to GST regime.

BENEFITS OF GST

GST will bring numerous benefits to all stakeholders viz industries, government and citizens. Some of these benefits are listed below:

1. Seamless Flow of Credit: GST will facilitate seamless credit across the entire supply chain and across all States under a common tax base.

2. **Elimination of Cascading effect:** Goods & Service Tax would eliminate the cascading effects of taxes on production and distribution cost of goods and services. The exclusion of cascading effects i.e. tax on tax will significantly improve the competitiveness of original goods and services in market will lead to beneficial impact to the GDP growth of the country. It is felt that GST would serve a superior reason to achieve the objective of streamlining indirect tax regime in India which can remove cascading effects in supply chain till the level of final consumers.

3. Revenue Gain: Revenue will increase under GST regime because of widening of the dealer base by capturing value addition in the distributive trade and increased compliance.

4. Enhanced Transparency: GST regime shall enhance transparency in the indirect tax framework and is expected to bring down the rate of inflation.

5. Zero rated Exports: Under the GST regime, exports will be zero rated in entirety unlike the present system where refund of some taxes is not allowed due to fragmented nature of indirect taxes between the Centre and the States. All taxes paid on the goods or services exported or on the inputs or input services used in the supply of such export goods or services shall be refunded.

GST will boost Indian exports, thereby improving the balance of payments position. Exporters will be facilitated by grant of provisional refund of 90% of their claims within seven days of issue of acknowledgement of their application, thereby resulting in the easing of position with respect to cash flows.

6. Increased Uniformity: Uniform GST rates will reduce the incentive for evasion by eliminating rate arbitrage between neighboring States and that between intra and inter-State sales. Harmonization of laws, procedures and rates of tax will make compliance easier and simple.

There would be common definitions, common forms/formats, common interface through GST portal, resulting in efficiencies and synergies across the board. This will also remove multiple taxation of same transactions and inter-State disputes like the ones on entry tax and e-commerce taxation existing today.

7. Increased Certainty: Common procedures for registration of taxpayers, refund of taxes, uniform formats of tax return, common tax base, common system of classification of goods or services along with timelines for every activity will lend greater certainty to taxation system.

8. Increased Digitalisation:

GST is largely technology driven. The interface of the taxpayer with the tax authorities will be through the common portal (GSTN). There will be simplified and automated procedures for various processes such as registration, returns, refunds, tax payments, etc. All processes, be it applying for registration, filing of returns, payment of taxes, filing of refund claims etc., would be done online through GSTN. The input tax credit will be verified online. Electronic matching of input tax credit across India will make the process more transparent and accountable. This will encourage a culture of compliance. This will also greatly reduce the human interface between the taxpayer and the tax administration, leading to speedy decisions.

UNIT - 4 : PUBLIC DEBT

MEANING OF PUBLIC DEBT

Public debt is a debt or loan taken by the government internally from banking institution and people as well as externally from foreign countries. It is a term used for short-tern and long-term borrowings of the government. The government may borrow internally from banks, business organisations, business houses, individuals and also from foreign countries. Thus, the borrowings of the government may be within the country or outside the country or both. The public debt is generally in the form of bonds or treasury bills if the loans are required for a short period which carries with them the promises of the government to pay interest to the holders of these bonds at stipulated rate of interest at regular intervals, or lump sum at the end of the stipulated period, in addition to the principal amount which has to be repaid at the stated time.

In the words of Philip E. Taylor, "The debt is in the form of promises by the treasury to pay to the holders of these promises a principal sum and in most cases interest on that principal."

According to J. K. Mehta, "Public debt is a comparatively modern phenomenon and has come into existence with the development of democratic form of governments in the world."

Since current public revenue is usually insufficient to meet the current and development expenditure of the modern government, the government has no alternative except to borrow money within the country or outside the country or both. While differentiating public deb from public revenue, Prof J. K. Mehta has rightly remarked, "Public revenue consists of the money that the government is not obliged to return to the very individuals from whom it is obtained, public debt on the other hand, carries with it the obligation on the part of the government to pay money back to the individuals from whom it has been obtained." According to Prof Findley Shirras, "National debt is a debt which a state owes to its subject or to the nationals of other countries.

OBJECTIVES OF PUBLIC DEBT

In India, most government debt is held in long-term interest bearing securities such as national savings certificates, rural development bonds, capital development bonds, etc. In industrially advanced countries like the U.S.A., the term government or public debt refers to the accumulated from famount of what government has borrowed to finance past deficits.

In such countries the government debt has a very simple from he relationship to the government deficit the increase in debt over a period ad also (say one year) is equal to its current budgetary deficit. But, in India, the term is used in a different sense.

The State generally borrows from the people to meet three are kinds of expenditure:

(a) to meet budget deficit,

(b) to meet the expenses of war and other extraordinary situations and

(c) to finance development activity.

(a) Public Debt to Meet Budget Deficit

It is not always proper to effect a change in the tax system whenever the public expenditure exceeds the public revenue. It is to be seen whether the transaction is casual or regular. If the budget deficit is casual, then it is proper to raise loans to meet the deficit. But if the deficit happens to be a regular feature every year, then the proper course for the State would be to raise further revenue by taxation or reduce its expenditure.

(**b) Public Debt to Meet Emergencies like War**

In many countries, the existing public debt is, to a great extent, on account of war expenses. Especially after World War II, this type of public debt had considerably increased. A large portion of public debt in India has been incurred to defray the expenses of the last war

(**c) Public Debt for Development Purposes**

During British rule in India public debt had to be raised to construct railways, irrigation projects and other works. In the post-independence ers, the government borrows from the public to meet the costs of development work under the Five Year Plans and other projects. As a result the volume of public debt is increasing day by day.

THE BURDEN OF PUBLIC DEBT

When a country borrows money from other countries (or foreigners) an external debt is created. When a country borrows money from others it has to pay interest on such debt along with the principal amount. This payment is to be made in foreign exchange /currencies (or in gold). If the debtor nation does not have sufficient stock of foreign exchange (accumulated in the past) it will be forced to export its goods to the creditor nation. To be able to export goods a debtor nation has to generate sufficient exportable surplus by curtailing its domestic consumption.

Thus an external debt reduces society's consumption possibilities since it involves a net subtraction from the resources available to people in the debtor nation to meet their current consumption needs. In the 1990s, many developing countries such as Poland, Brazil, and Mexico faced severe economic hardships after incurring large external debt. They were forced to curtail domestic consumption to be able to generate export surplus (i.e., export more than they imported) in order to service their external debts, i.e., to pay the interest and principal on their past borrowings.

The burden of external debt is measured by the debt-service ratio which returns to a country's repayment obligations of principal and interest for a particular year on its external debt as a percentage of its exports of goods and services (i.e., its current receipt) in that year. In India it was 24% in 1999. An external debt imposes a burden on society because it represents a reduction in the consumption possibilities of a nation. It causes an inward shift of the society's production possibilities curve.

DISTINCTION BETWEEN PUBLIC DEBT AND PRIVATE DEBT

What is public debt? Debt means borrowing of funds from another. Public debt therefore, refers to an amount borrowed by the government hom it public or from foreign agencies to meet the deficit of public revenue and public expenditure. Thus government resorts to this source of finance only when the expenditure of the government exceeds the public revenue. Findlay Shirras has defined public debt as- "National debt is a debt which a state owe to its subjects or to the nationals of other countries," An individual also takes loan from another person or institution. Public debt (loan taken by the government or government debt) and private debt (loan taken by an, individual) have the following points of differences.

(1) Power of Compulsion. The government holds the sovereign power in her hands and can force the people of the country to lend to her in case; of need or emergency. Any avoidance or defiance of orders may be declared illegal. An individual' cannot force another individual to lend him money even in emergency.

(**2) Power of Repudiation.** The government can repudiate loans taken by it from the public at any time and without an obligation but an individual can, under-no circumstances refuse to pay loans to another person. He can be forced to repay loans through legal recourse.

(**3) Durability of Debts:** The government is a continuous changing institution. So, a government can contract loans from the public for a very long time. But, an individual cannot however contract loans for such a long period. He can secure loan only for a short period.

(4) **External and Internal Debt:** The government can borrow funds from internal and external sources. In other words, the government can borrow funds from itself or from others. When government resorts to print paper notes etc., to cover the deficit, it is amount to taking loans from itself. But when it borrows from the public or from foreign governments of international agencies, it amounts to loans taken from outside sources: An individual, on the other hand, cannot borrow from himself and from a foreign government or agency. He can borrow only from another person or national institutions.

(**5) Payment through Taxation.** The payment of public debt i done through taxing the people. Additional taxation is levied on the people with a view to repay the amount of loan. The burden of which is also borne by the creditors. As against this, an individual cannot increase the volume of income to repay loans and the burden of private debt is never borne by the creditors in any form.

(6) Rate of Interest: Since the credit of the government is high in the eyes of the public and those of the foreign people and governments, the rates of interest on public loans are very low as compared to rates of interest on private loans.

(7) Purpose of Loan. The main aim of public debt is to promote public welfare including the creditors. The amount of loan spent on developmental projects benefit the people including the creditors. On the contrary private debt does not benefit the creditor at all. Public debt is always spent for productive purposes whereas; private debt may be spent for productive and non-productive purposes.

(8) Impact on Economy . The impact of public debt is to contain the inflationary pressure in the economy, because the purchasing power of the people is reduced by public debt. On the contrary, the individuals are not allowed to take loan with such a view.

(9) Liquidity. Public debt certificates can be sold in or purchased from the market if the creditors like to realize the loan or invest their surplus funds. But the private debt can be repaid only by the debtor and the creditor cannot realize it as and when he likes before maturity.

Thus the nature of public and private debt is fundamentally different because the activities of toe two are not similar in nature.

SOURCES OF PUBLIC DEBT

Every government has two major sources of borrowing-(I) internal and (II) external. Internally, the government can borrow from individuals, financial institutions, commercial banks, non-banking institutions, and central bank. Externally, the government borrows from individuals and banks, international institutions and foreign governments. Now we shall discuss both the sources of raising debts:

(I) Internal Sources of Public Debt

Internal sources of raising public debt are as follows:

(1) Borrowing from Individuals. One of the important methods of raising public debt from individuals is in the form of bonds, debentures or loan. They bear a fixed rate of interest and are repayable on due dates. They are purchased by individuals from the government and are repaid by the government on due dates.

(2) Borrowing from Commercial Banks. Public debts are also raised by the government from commercial banks in the form of loans. Commercial banks can subscribe to government loans through creation of credit.

(3) Borrowing' from Non-banking Financial Institutions. Non banking financial institutions, such as, insurance companies, trusts, mutual savings banks etc. subscribe to government bonds and thus, it is also an important source of raising public debt. These non-banking financial institutions prefer government bonds because of the security provided by the latter and also due to their high negotiability and liquidity.

(4) Borrowing from Central Bank. The central bank of country is also an important subscriber to the government loans. Central bank purchases bonds of the government both Central Government and the State Governments. By purchasing government bonds, the central government credits the account of the government concerned.

(**II) Borrowing from External Sources** .External sources of borrowings include foreign individuals and foreign banks, international institutions and foreign governments. In recent years, apart from other foreign sources, two important sources of raising foreign public debts have become prominent. They are (i) I.M.F., I.D.A., L.F.C, I.B.R.D., which give loans for short term mainly for overcoming temporary balance of payment difficulties and also for the long term for development purposes. (ii) Government assistance is det generally for development projects to mainly underdeveloped and developing countries like India. External sources of borrowing are becoming considerably important in recent years.

EFFECTS OF PUBLIC DEBT/ BORROWING

The economic effects of public debt depend on the nature, form, and conditions, duration, rate of interest, the mode of repayment etc. of Indian public debt. As a matter of fact all types of loans affect the different sections of the society. Its uniqueness lies in the fact that it has revenue effects as well as expenditure effects.

Firstly, raising of money by way of loan makes the people change their budgets. Though it may not affect the consumption expenditure directly as the taxation does, because people use their past or present savings to purchase the public securities of small amounts. Thus, the public debts affect consumption expenditure.

Secondly, the benefits, conferred upon the people by the expenditure of the money raised through public loans have another kind of effects on the economy. These benefits may not always be different from the benefit that expenditure of tax income may confer, provided the same use is made of borrowed money as is made of tax revenue.

Effects of Public Debt or Economic Effects of Public Debt.

Now we shall discuss the effects or economic effects of public deb under the following specific heads:

(**1) Effects on Consumption.**

When people purchase public loan (government security) it is not always necessary that they do it out of past savings. Sometimes people buy these public loans out of their present income which they could otherwise spend in purchasing some other commodity. In this way people refrain from consumption and buy public loan. Therefore, the consumption is affected in the same way as it is affected by taxes. In times of war or in period of emergency, substantial pressure may be applied to induce individuals to curtail consumption and to subscribe to government loans. The other possibility is when the government bonds may offer special advantages, such as, tax exemption, higher interest rates etc. In these circumstances also, people generally refrain from consumption and invest their money in public debts/bonds.

(**2) Effects on Investment-Production.**

If people buy government bonds/securities by withdrawing money from their industrial concerns or by selling debentures and shares of industrial concerns or financial institutions and even commercial hanks subscribe to government loans out of funds meant for investment or for accumulation of stocks, then the investment is adversely affected, leading to adverse effects on production. However, if the government utilizes this money in commercial public enterprises, the total investments available for production may not be adversely affected. On the contrary, if the government utilizes it on non-productive works, the total investment may be adversely affected, resulting in adverse effects on production also. Thus, if the loans raised by the government are utilizes for productive purposes directly, they increase the income of the community, leading to an increase in consumption, thereby increase in production.

(3) Effect on Distribution.

Public debts also affect distribution. If the public loans are subscribed by rich people only and the amount so utilizes is spent by the government on the economic welfare of poor people or low-income groups, the benefit will be a narrowing down of inequalities and a more equal distribution of income between people. But if the burden of public debt along with interest payment falls on the poorer classes also, the tendency of public debt would be to increase the inequalities of incomes. If the public loans are of small amount to the extent that poorer sections of the society can also subscribe to the public loans easily, then the payment of interest will be to the poorer people of the society resulting in the reduction of inequalities. However, if the bond holders and the tax-payers are identical, there would be no net redistribution of income, this need not be the case. Accordingly, some redistribution of income will take place so long as the tax-payers and the bond-holders belong to different groups.

(4) Level of Economic Activities or Effects on Economic Activity and Employment.

Public debt also affects the economic activities and employment situation in a country.. Some economists hold the view that this should be the only object of public debts. The aim of public debt should not be only to get money for the government but it also affects the level of economic activities and employment situation. As a matter of fact, public debts reduce the quantity of money in the hands of the people and their purchasing power is automatically curtailed. This ultimately affects the country's price level and employment situation. Both are adversely affected. Thus, the public debt is the most effective means of controlling the inflationary trend of the economy of the country. On the contrary, in times of depression when the level of prices, production, consumption, decreases. unemployment increases and the financial institutions are under financial crisis, the state government takes loan on the security of the public securities from the central government and spends the money on development programmes, such as, irrigation projects, roads, transport and establishment of new commercial public undertakings resulting in an overall increase of money in the hands of the people and also rapid increase in employment opportunities in the country. In this way, the situation of depression also disappears.

(5) Effects on Foreign Loans.

Foreign loans can influence both consumption and investment favourably. Foreign loans are meant to finance the import of goods without paying for them immediately through exports. If foreign imports consist of consumer goods, they tend to reduce the inflationary pressure which may exist due to shortage of goods. On the other hand if foreign imports consist of high priority goods and services, such as, machinery, industrial raw materials, technical know how etc., it will have favorable effect of speeding up utilization as well as rapid growth of the economy. On the contrary, if foreign loans are meant to finance a war or to utilizes on army, it will not have any positive effect on investment etc.

(6) Effects on Liquidity.

People who buy government securities possess highly negotiable and highly liquid form of assets. They can be used for any purpose at any time, such as, taking loan from the bank or for speculative nature.

(7) Effects on Resource Allocation and National Income.

Unlike tax finance, there is little effect of public debt on resource allocation and national income. When investment level is reduced, it causes decrease in the relative output of capital goods against the total output in periods of full employment. On the contrary, the capital goods on which the government expenditure is incurred find greater incentives for their accelerated production and, thus, there is also a rise in national income. The consequential increase in national income will not only be of high level in proportion to the enlarged investment but will be a multiple of the increment of the investment due to multiplier effect, and hence will create larger employment prospects and increase in national income.

(8) Effects on Money Market.

Existence of public debt also affects the money market. For example, if demand of funds from the private sector is on a higher level, government will have to fix higher interest rates to attract purchases of its securities and vice versa. Thus, it has to conform to the general pattern of demand, supply and prices as any other borrower in the market.

(9) Effects on Private Sector.

Public expenditure increases the demand of goods because it increases the purchasing power of the people and puts more money in circulation. However, when the expenditure is financed through taxation, current consumption is reduced. On the contrary, when it is financed through public borrowings, idle savings are generally utilizes and thus the consumption is not reduced. If the borrowed money is utilized by the government for purchasing goods and materials produced in the private sector the demand of goods and materials in the private sector is increased to that extent.

(10) Effects on Cost of Production.

The cost of production depends upon the prices of raw materials and other factors used in production. If the government utilizes the borrowed money to supply raw materials etc. to producers at cheaper or on utilized rates, on providing cheaper transport and on providing cheaper technical and non-technical training to the workers, the cost of production is reduced to a great extent.

(11) Effect on Production.

As Mrs. Hicks points out, a large public debt cannot be regarded with complete indifference, since it needs a considerable proportion of national income to be devoted to the payment of service charges, such as interest, the principal and cost of debt management. There are expansionary effects of a large internal public debt even after the period of borrowing is over. The existence of government securities imparts increasing liquidity to the economy. They form the basis of lending for banks. Banks can secure advances from the central bank against government securities pledged to them and in turn, create more deposits through their lending operations. Similarly, government securities are used as collateral securities by individual borrowers. Unused margins may be used and new money can be created by banks. Therefore, the floating of debt does not except in rare cases, reduce production in the present. For, actually paying off the loans generates the process of transferring money from expenditure to savings. Therefore, there comes more capital into being than would otherwise have been possible. In future, there is a remote possibility, the reduction in consumption as stated above may cause the production to be reduced to some extent.

(12) Effects upon Employment.

When the government borrows the savings of the people, it affects adversely the capital formation and the level of production of the country. If the government utilizes money in unproductive channels, it does not affect production and unemployment at all. On the contrary, if the government borrows money for productive purposes, it creates additional employment opportunities in the country.

MEANING OF REDEMPTION OF PUBLIC DEBT

Redemption means repayment of a debt. Just as the private individual or organisation has to repay the loan he or it has borrowed, so also the government has to pay not only interest on the public debt but also repay the principal on the due date. The sooner the debt is cleared, the better for the government. Hence, every government tries to redeem the loan at the earliest. However, the redemption of debt or loan depends upon the nature of debt. If debt is taken for productive purposes, it may not be strictly necessary to redeem it at the earliest because the government is also getting a source of income to payoff the interest of the debt. On the contrary, if loan is taken for non-productive purposes such as war debt, the sooner it is paid off, the better, both for the government as well as for the public, because it is burden without any return. Accumulation of such a debt may cause bankruptcy.

METHODS OF REDEMPTION OF PUBLIC DEBT

Following are the main methods of the redemption or repayment of public debt.

(1) Repudiation. Repudiation of public debt means refusal to repay a public debt by the government. It means that the concerned government does not recognize its obligation and refuses to repay the loan taken by it. Repudiation is not paying off a loan but destroying it. This method was followed by the U.S.A. after the civil war and by the U.S.S.R. after the 1917 revolution. However, this method is most undesirable because (1) it shakes the confidence of the people in public debt, (ii) may provoke retaliation from the creditor countries, and (iii) it is considered immoral and dishonest. That is why this method of redemption of public debt has not been used recently anywhere in the world.

(**2**) **Refunding**. Refunding is the process by which the maturing bonds are replaced by new bonds. In this case new bonds are issued by the government in order to payoff the matured loans. This process of refunding involves no liquidation of money burden of the public debt.

(3) Conversion. Conversion of public debt means exchange of new debts for the old ones. In this method, the loan is actually not repaid, but it is converted into a new loan.

(**4) Annual Repayment.** Under this method of redemption of public debt, the public debt is repaid in equal instalments which include both the interest and the principal. It is done annually and hence, is also called terminal annuity. The main benefit of this method is that it leads to a fall in the burden of public debt every year.

(5) Sinking Fund. Sinking fund is probably the most popular and systematic method of redeeming public debt. Under this method, the government establishes a separate fund known as the 'Sinking Fund for the repayment of the public debt. The government goes on crediting every year fixed sum of money to this fund. By the time the debt matures, the fund accumulates enough amount to payoff not only the principal but also the interest charges.

(6) Serial Bond Redemption. The government may decide to pay off every year a certain portion of the bonds issued previously. Therefore, a provision may be made so that a certain portion of the public debt may mature every year and decision may also be taken in the beginning about the serial numbers of bonds which are to mature every year. This method enables a portion of the debt being paid off every year.

(**7) Buying up Loans.** The government may redeem its public debt through buying up loans from the market. Whenever, the government has surplus income in its budget, it may spend the amount for buying off government bonds from the marke where they are bought and sold. It is a good method, provided the government can secure budget surplus. However, this is not a redemption of debt but buying up a debt.

(8) Capital Levy. Public debt may also be redeemed through a capital levy which may be levied once in a way with the special objective of redeeming public debt. In fact, capital levy is usually advocated immediately after the war to repay the unproductive war debts. It is imposed on the net assets on progressive scale.

(**9) New Taxation.** Another method of redemption of public debt is to levy new taxes, both direct and indirect, and thus secure necessary revenue to payoff the old public debts. (10) Redemption of External Debt. The redemption of external debt can be made only through accumulation of necessary foreign exchange to pay it off. This can be done by creating export surpluses, i.e.. exporting more than imports. Temporarily, the redemption of an old debt can be made through the floating of new foreign debts.

Public debt

In recent times government's expenditure is increasing much faster as compared to their ability to raise resources. When expenditure exceeds revenue, deficit arises in the budget of the government. Now this deficit can be bridged either by imposing more 'taxes or by borrowing money from internal and external resources. The deficit can also be sustained to a certain optimum limit. But in case of underdeveloped, developed and developing countries there is a limit to which taxation can cover up the deficit in the budget without having adverse effect on the economy. Hence, after a certain limit the government of a country is bound to raise money through pubic debt in home or foreign agencies to cover the deficit in the budget. Hence, the method of public borrowing or raising public debt has been preferred by all the states alike - undeveloped, developed or developing for raising their financial resources. In modern times, the public debt is considered as a kind of income of the state.

GROWTH OF PUBLIC DEBT IN INDIA

Both internal and external loans have increased considerably over the planning period in India. Since loans have to be repaid after some years and interest payments are to be made regularly till such date, the loans are finally paid off, the burden of public debt has also increased tremendously. The total outstanding liabilities of the Central government, comprising internal and external liabilities as a proportion of GDP were 50.3 per cent in 2016-17. As far as external debt is concerned, it has to be repaid in terms of foreign currency and the servicing of such debt creates serious problems. As far as internal debt is concerned, it continuously rising magnitude has resulted in a rapid increased, its continuously rising magnitude has resulted in rapid increase in debt servicing burden. The interest payment charges on the Central Government's public debt increased from ₹ 606 crore in 1970-71 to ₹21,498 crore I 1990-91 and is estimated to be ₹ 4,83,069 crore in 2016-17.

However, the burden of public debt should not be considered only by taking into account the interest burden charges. Much depends on "how the funds mobilized through public debt are used. If public debt is wasted on unproductive activities it becomes a deadweight. On the other hand, if the resources raised by the government through borrowings are spent on developmental activities, they raise the productive capacity of the country, and are thus not burdensome. In India, a considerable amount of external loans has been used for general and maintenance of imports. As a result, our productive capacity has not increased as much as was possible with the appropriate utilization of external resources. Under the circumstances, the burden of servicing has become quite heavy.

On considering the internal public debt of the Government of India, we find that a substantial part of this has been used for productive purposes. A significant proportion of this was utilized for the development of industry and minerals, power projects, railways, postal ad telecommunications services etc. Among autonomous corporations, giants like the Steel Authority of India, Oil and Natural Gas Commission, Fertiliser Corporation of India, Heavy Engineering Corporation and a few others have greatly benefited from public borrowing. This clearly indicates that public debt has not always been wasted on unproductive activities. It has definitely contributed to the growth potential of the country.

The Inflationary Pressure

Public debt, if it is owned by the central bank of a country, would be a device to increase the supply of money. In India, as far as the permanent debt or funded rupee loans (these are loans which become repayable after twelve months of date of issue) are concerned, a major part of them is held by the Reserve Bank. This enables the Reserve Bank to issue additional quantity of money to the public for meeting its growing demand on account of increasing monetisation and economic development. The government also undertakes short-term borrowings by issuing treasury bills which are mostly held by the Reserve Bank. Treasury bills in this country represent deficit financing by the government and are invariably inflationary in their nature.

Sustainability of Public Debt.

The financial and debt crisis that originated in the developed world has brought into focus the importance of prudent fiscal management as well as debt management in assessing the vulnerability of a Government's debt position. There are various indicators to judge the sustainability of public debt and, in this discussion, we propose to take up a brief discussion of the following indicators: (1) level of debt, (2) interest payments, (3) short-term debt, and (4) external debt.

Level of debt.

As the outset, it may be stated that there is little consensus with regard to a level of debt that may be considered unsustainable. There are instances of countries with debt - GDP ratiosclose to or higher than 100 per cent without doubts on their ability to service debt. A secularly rising debt-GDF ratio can nonetheless be considered as leading towards stability. On this ground, the level of debt in India during the period of the last decade or so, points toward the sustainability of India's public debt. India's debt had gone up consistently during 1980s and 1990s and the combined debt-GDP ratio of the Centre and States had reached a peak of 83.2 per cent by the end of 2003-04. Debt-GDP ratio has shown a broadly declining trend. According to the Status Paper on Government Debt, 2016, the marginal increase during 2008-09 and 2011-12 was mainly on account of global factors and the increase was significantly lower than that of many other countries witnessed during that turbulent period. Of late, debt-GDP ratio has shown a declining trend and was 68.6 per cent at end-March 2017. Reduction in debt has taken place at both the Central level and States' level. For Centre, the debt-GDP ratio declined from 66.0 per cent in 2003-04 to 50.3 per cent in 2016-17. Similarly, for States, debt-GDP ratio declined from 31.8 per cent in 2003-04 to 23.9 per cent in 2016-17.

Interest payment.

Another important factor that needs to be considered while determining the sustainability of public debt is the 'interest cost of debt. In this context, the Status Paper quoted above considers two aspects: (1) the ratio of interest payments to revenue receipts and GDP, and (ii) average interest cost (which is arrived at by dividing interest payments during a year with average debt stock). The paper notes that the position is satisfactory on both counts. As far as the ratio of interest payments to revenue receipts is concerned, it fell significantly from 53.4 per cent for Centre in 2001-02 to 33.9 per cent in 2016-17. Over the same period, the ratio of interest payments to GDP declined from 4.7 per cent to 3.2 per cent (the only exception was the immediate period after the global financial crisis of 2008). Similar trends are found in the case of State governments' debt and the combined debt of Centre and States. In this context, the Paper also points out that in recent years "nominal growth rate in GDP has been well above the average interest cost, implying that the growth in revenue generation through GDP is likely to exceed the growth in interest obligations. This is likely to further push down the interest payments/ revenue receipts ratio providing more fiscal space for other expenditure".

Short-term debt.

For examining the sustainability of debt, it is also necessary to consider the period of maturity. A greater proportion of short-term debt in total debt increases the risk profile and hence reduces the sustainability of debt. In this respect also, the situation seems to be comfortable. As far as the Centre is concerned, its short-term debt declined noticeably during the first half of 2000s with its share in public debt declining to a low of 6.2 per cent in 2003-04. It, however, rose consistently thereafter with its share in the public debt increasing to 13.8 per cent in 2008-09. Since then it has been declining gradually with medium-term downward tend. It stood at 12.3 per cent of public debt and 5.2 per cent of GDP at end-March 2016. The share of short-term debt in public debt has been declining gradually since 2011-12 for the States

External debt.

Higher is the proportion of external debt in the overall debt, higher is the risk from currency fluctuations. In India, government debt is predominantly raised from a domestic investor base. This would be clear from the fact that the share of external debt is not only low but has declined during recent years. The share of external debt in general government debt declined from 10.8 per cent at end-March 2002 to 4.0 per cent at end-March 2017. As per cent of GDP, external debt declined to 2.7 per cent from 8.5 per cent over the same period. The low share of external debt insulates the debt portfolio from currency risk.

On account of the above reasons (and also due to the fact that most of the debt is at fixed interest rates which minimises volatility on the budget and reduces interest rate risk to the government), the Status Paper concludes that the debt profile of the government is within sustainable limits, and consistently improving.

States Problems

While the responsibilities of the State governments have increased over the years resulting in higher and higher expenditures, their revenues have failed to increase much as compared to expenditure. This is partly due to the failure of the State governments to tap their tax potential fully, for instance, State governments have made no attempts to bring agricultural incomes in the tax net. The policy of prohibition pursued by some states has wiped out an important source of their revenue. Large investments made by the State governments in State Electricity Boards irrigation schemes and industrial enterprises have failed to generale expected returns. Naturally the emphasis on public debt has increased Here also the States face a problem as they do not have much capacity to borrow. The State governments' loans offer low returns and thus fail to attract investors.

Like the Centre, the States do not have a 'captive market for the loans. Their dated loans are generally subscribed by those individual and commercial establishments who seek favours from local bureaucrati and thus act according to their advice. The Reserve Bank's holdings of the State governments' loans are rather small. Under the circumstances the States' dependence on the Centre is bound to be high. This tilt in the 'power balance in favour of Centre gives it immense powers to influence the decision-making process at the State level and build up pressures on the State governments. The latter have also acted irresponsibly and have not taken adequate steps to tap their resources effectively. To relieve the burden of debts on the State governments, the Finance Commissions have recommended debt reliefs to states. Such relief measures, however, offer no lasting solutions to the problems of the States. What is required is that the State governments tap heir resources effectively and utilize them (and funds obtained through borrowings efficiently so that their repaying capacity grows.

PUBLIC DEBT MANAGEMENT

As stated earlier, public debt is composed of two parts - external debt and internal debt. As far as external debt is concerned, it is not difficult to redeem a part of it as India's foreign exchange reserves stood at $370 billion as at end-March 2017. As far as internal debt is concerned, the following measures are frequently suggested to reduce its burden:

1. **Reducing public expenditure and increasing revenues.** The first and the foremost method of reducing public debt is, of course, reducing public expenditure and increasing revenues. It is very difficult to reduce public expenditure. In fact, in a rapidly developing economy like India, public expenditure is bound to increase with years. In an effort to reduce fiscal deficit, the Government of India has been reducing the capital expenditure - GDP ratio over the years (from 5.4 per cent in 1990-91, this ratio has been reduced to 2.0 per cent in 2010-11 and further to only 1.8 per cent in 2016-17). This is not desirable as a decline in capital expenditure- GDP ratio has the potential to disrupt the growth process. As far as raising revenues is concerned, suggestions have been made to increase tax revenues and/ or non-tax revenues. As far as raising tax revenues is concerned, increasing the rates of taxation is not a feasible proposition as tax rates are already high in India (particularly, in the context of the low tax paying capacity of the people). As suggested by Martin Feldstein, it is better to seek ways to increase collections with the existing law by reducing pure tax evasion. A second best strategy would be to find ways to reduce loopholes that allow technically legal but unjustifiable tax avoidance. As far as non-tax revenues are concerned, charges for government services can be an important source of revenue as the government in India provides a wide range of public services.

2. Reduction in the interest rate. Reducing the interest rate on the government debt can help in reducing the burden of public debt and in brining down the debt GDP ratio. Even if interest rate cannot be reduced/ directly, it can be reduced indirectly by actions that make the debt less risky. A sound monetary policy that reduces inflation risk can reduce the real interest rate. Budget policies that reduce future primary deficits can also reduce the real rate of interest.

3. Selling contraband gold to retire debt. The government has confiscated large quantities of contraband gold that has come in through smuggling. Now India's foreign exchange reserves have reached a satisfactory level. Thus, a substantial part of the gold reserves created by confiscating contraband gold can be sold in auction and the proceeds may be utilised to retire public debt.

4. Using amount realised from disinvestment.

The government has been pursuing the disinvestment policy since 1991-92. The main rationale behind disinvestment programme has been to raise resources for bringing down the fiscal deficit. This policy is totally irrational and violates the basic principle of public finance that under no circumstance capital receipts are to be used for meeting revenue expenditure. Since 1991-92 the total receipts from various rounds of disinvestment till March 31, 2018 amounted to Rs. 3,47,440 crore. The major part of it should have been used to retire public debt. But in practice this was not to be. In future, the government should revise its approach and utilise the resources generated through disinvestment for retiring the public debt.

5. Selling a part of the vast real estate to raise resources. The Government of India owns a large part of real estate in the country. railways, in particular, hold a large amount of land along and around rail tracks. Some economists have suggested that the government can sell a part of the real estate it holds and use the amount thus generated to retire public debt. As emphasised by Chelliah, "the sale of assets should be matched by an equivalent reduction in liabilities. The proceeds of the sale of assets should not be used to finance government expenditure."

UNIT - 5: PUBLIC BUDGET

MEANING OF BUDGET

Budget is a statement of annual receipt and expenditures of the government as expected over the financial year, April to March 31. It also includes government report on its financial performance over the past one year. However, this part of the budget is often overlooked as a description of what has happened. Importance is given largely to the other part of the budget describing what is going to happen in terms of the expected receipts and expenditures of the government in the year to come.

According to Harlod R. Bruce, "A budget is a financial statement, prepared in advance of the opening of a fiscal year, of the estimated revenues and proposed expenditures of the given organization for the ensuring fiscal year."

In the words of Munro, "Budget is a plan of financing for the incoming fiscal year. This involves an itemized estimate of all revenues on the one hand and all expenditures on the other."

According to Rene Stown, "Budget is a document containing a preliminary approved plan of public revenue and expenditure."

According to Rene Gaze, "The budget in a modern state is a forecast and an estimate of all public receipts and expenses and for certain expenses and receipts an authorization to incur them and collect them."

TYPES OF PUBLIC BUDGET

Following are the types of budget.

(i) Executive Type: In this type Budget is prepared by the executive, and after it has been approved by the Legislature, responsibility for its execution lies with the executive. This is the commonly accepted principle of Budget preparation and execution. In modern times the Executive type of Budget is in vogue. It is felt rightly that the Executive is the best judge of the requirements of the various spending agencies, so it should prepare the estimates of income and expenditure, and submit its financial plan to the Legislature. The Executive Budget is' prepared by experts, and in almost all countries some special agency is provided to help the Chief Executive in the preparation of budget. The Bureau of Budget in the United States, Treasury in Britain and Finance Department in India are the expert agencies which prepare the Budget on behalf of the Executive.

(ii) Annual or Long-term Budgets: Generally, the Government budgets are annual i.e., they are prepared for one year. In India, England and most of the other commonwealth countries, the financial year begins on 1". April and ends on the 31 March, but in the U.S.A., Australia, Sweden and Italy the dates are 1". July and 30th June. In France these dates are 1st January and 31st December. Some countries have adopted the policy of planned economy and to meet the needs of long term planning they have resorted to long term budgeting, i.e., preparing the budget for three or more years. Such budgets are in fact long-term planning over a period of years to finance the plan. These countries spread the estimated plan expenditure over a number of years. The Legislature approves the plans along with its estimated expenditure, but that does not amount to actual voting of appropriations for the entire period. Every year the national budget will include the expenditure on the plan for that year which will be approved by the legislature.

(iii) Single or Plural Budget: When the estimates of all the Government undertaking find place in one budget, it is known as single budget. The advantage of single budget is that it reveals the overall financial position of the Government, as a whole. But if there are separate department-wise budgets which are passed separately by the Legislature, it is called plural budgeting. In India we have two budgets-one for the railways and the other for all the other remaining departments. The practice of having a separate railway budget started in 1921. In England there is single budget.

(iv) Surplus, Deficit or Balanced Budget: Excess of estimated revenue of the year over the anticipated expenditure is known as Surplus Budget. Surplus Budget shows financial soundness of the government. In case of individual budget and family budget, surplus Budget is preferable, but in case of government surplus budget is not favoured, because it shows that the government instead of spending for the welfare of the people is busy in earning income and amassing wealth. As such these days government budgets are not surplus budgets.

Deficit Budget:

Deficit Budget is an economic situation, wherein estimated government expenditure exceed the anticipated revenue. After the great depression of 1930s surplus and balanced budgets were abandoned by the governments, because it referred to discouraging the economy from growth. In order to overcome the shocking impact of the great depression, it was felt that that policy of deliberate excessive expenditure by the government over its revenue (deficit budget) should be preferred as a measure to set the economy on the path of economic recovery. It was argued that how can the government spend more than its revenue. The remedy of this economic problem was found in the deficit financing, which was termed as financing of deliberately created gap between public revenue and public expenditure or budgetary deficit.

Balanced Budget:

Balanced Budget is a situation, in which estimated revenue of the government during the year is equal to its anticipated expenditure. Balanced Budget is always preferable for individuals and family. Most of the classical economist," favoured balanced budget which was based on the golden policy of 'Live within means. The policy of balanced budget was also favoured, because minimum interference from the government was desired in economic activities. The policy of balanced budget was reviewed ill the great depression of 1930s, when it was realised that the government can play an effective role in the recovery of the economy by its fiscal and monetary policies. It was also argued that if government expenditure exceeds its revenue it will generate additional demand which will accelerate the pace of economic growth. As such the policy of surplus budget was almost aban doned by all governments.

(**v) Cash or Revenue Budget:** A cash budget is one wherein the estimates of the various items of income and expenditure include the amounts actually to be received or spent in one year.

(**vi) Revenue and Capital Budget:** For sometime past, in some countries including India, it has become customary to distinguish between 'revenue budget' and 'capital budget' the former relating to the current financial transactions of the state and the latter involving transactions of a capital nature.

(**vii) Zero Based Budget:** In Zero Based budgeting organizations preparing their budgets should not take earlier years expenditure for granted, as in the case of conventional budget, but should state everything afresh. It means that while framing its budget for the coming year an Organisation should start from zero point, instead of treating the current budget as the starting point or base for next year's budgetary exercise.

In the broader sense, zero base budget concepts involve a complete re-examination of ongoing programmes to assess their continued utility instead of following the method of incremental approach to budgeting.

OBJECTIVES OF A GOVERNMENT BUDGET

It should be kept in mind that rapid and balanced economic growth with equality and social justice has been the general objective of all our policies and plans. General objectives of a government budget are as under:

(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 (D11; A10):** 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 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.

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.

IMPACT OF THE BUDGET

A budget impacts the society at three levels,

(i) It promotes aggregate fiscal discipline through controlled expenditure, given the quantum of revenues,

(ii) Resources of the country are allocated on the basis of social priorities, (iii) It contains effective and efficient programmes for delivery of goods and services to achieve its targets and goals.

CHARACTERISTICS OF PUBLIC BUDGET

Prof. A.E. Buck point out that, as a financial plan, the budget should possess certain essential features. We call it as the requisite of a good budget.

1. Comprehensiveness: This quality insists that budget must exhibit all revenue and expenditure relating to government transactions. This feature is called "the rule of unity". This principle insists that there must be a single fund and all money collected must be accumulated into what is called 'Consolidated Fund'. This rule ensures simplicity and efficiency in government transactions.

2. Equilibrium or Balance: This quality is emphasized by the earlier writers. The balancing of revenue and expenditure is rightly deemed to be the essence of a good budget. However today there is a radical departure from this classical concept. A writer like Jacob Viner strongly opposes this concept.

3**. Annuality:** This principle insists that budget should be voted at regular intervals generally a year is regarded as the proper span of time to which budget should relate. Later writers on public finance added some more features as essential qualities of a good budget.

They are:

4. the budget should possess certain degree of flexibility regarding allocation of resources and implementation of proposals.

5. Accuracy is another characteristic of budget. It means that estimates given in the budget should as far as possible be accurate based on reliable information and data. 6. Objectively is another prerequisite of a good budget. At all times and in all places, budget is prepared with certain well defined objectives.

CANNONS OR PRINCIPLES OF PUBLIC BUDGETING

Budget is a technique to achieve administrative efficiency in financial resource management. It is an instrument to execute the varied financial and economic programmes of the government in a phased manner.

The preparation and execution of the budget requires the adoption of creation principles in line with the objective set. Prof. Harrod. D. Smith set out certain canons or rules which are called as the basic principles of budgeting. The followings are main canons of any public budget.

1. Executive Programming: Being the programme of the chief executive, the budget should reflect all government responsibilities and activities. The social, economic and political programmes of the government should be clearly unveiled in the budget programme. Then only it becomes a work programme for onward execution. Therefore it should be under the direct supervision of the executive.

2. Executive Responsibility: Chief Executive should ensure that the departmental programmes planned are capable of fulfilling the desire and intention of legislature. Moreover economy must be observed to the possible extend in the execution of the budget programmes.

3. Reporting: All budgetary procedures like preparation, enactment and execution of programmes, must be based upon authentic data and information gathered from various administrative units of the government. Information regarding the progress of the work, programmes executed, revenue mobilized and expenditures made should be furnished to the executive periodically. This is a fundamental requirement for a good budget.

4. Flexibility in Budgeting: Budget should be flexible enough to meet the government's financial policies according to the changing socio-economic conditions in the society. 5. Adequate Tools: The chief executive should be armed with sufficient and adequate administrative tools to fulfill its budgetary responsibilities. A well-equipped budget office must be there under the direct control and supervision of the executive, to carry out the budgetary programmes.

6. Multiple Procedures: Modern governments have to perform varied functions of different nature, which requires an altogether different technique of management. Sometimes even with in the same administrative unit different projects require different management procedure, skill and techniques. However in a government budget this multiple procedure will be reflected in a unified form or manner.

7. Executive Directions: All possible details of each project should be spelt out in the budget document in-order to make the budgeting more effective. The appropriation of funds, if possible should be made to broadly defined functions of the department. The details contained in the budget should be transparent and there should be no chance for apprehension for the legislature.

8. Active Co-Operation: Efficient budgeting depends upon the active co-operation of all departments and their sub-divisions. It is a basic requirement for the successful implementation of the programmes in the budget. Therefore, in each department there must be a budget office.

Above all the budget document should be comprehensive enough to include explanatory statements regarding the entire financial position of the government. It should be lucid, clear and understandable to the common man.

PRESENTATION & PASSING OF PUBLIC BUDGET IN INDIA

Budgeting in India. In India, the budget is the annual financial statement of accounts for the proceeding and current year, and the estimates of the revenue and expenditure of the coming year. The departmental officials prepare the estimates for the coming financial year, on the basis of the revised estimates of current year. After the estimates have been prepared by the various departments of the Government, the Annual Financial Statement for the coming year is laid before, both the Houses of Parliament. In India, this financial statement is placed before the Lok-Sabha and Rajya-Sabha every year.

PRESENTATION OF THE BUDGET

In India, the Budget is presented before the Parliament in the month of February every year. The Budget is classified into Revenue Account and Capital Account. The former refers to the revenue receipts (tax receipts) and the recurring expenditure, 'while the latter refers for the capital receipts and expenditure of capital nature. It implies, that Revenue Account and Capital Account each have two components, that is revenue and capital expenditure. This is also known as economic classification of budgetary transactions.

The Finance Minister makes a speech in the Lok Sabha at the time of presentation of the Budget. There is no discussion there on. The Budget speech is a very important document. It gives a review of the economic conditions of the country and the reasons for the financial proposals of the government. The factors which have affected the economic growth and employment in the country are given. Besides, the fiscal, monetary and financial trends at home and abroad are reviewed in the budget speech. The reasons for the surplus or deficit in the budget are mentioned in the budget speech.

General Discussion

After the Financial Statement has been presented to the Houses, a general discussion takes place in both the Houses. It should, however, be noted that no item of expenditure is exempted from general discussion. Expenditure charged upon the consolidated or the expenditure which is not a subject to the vote of the House, is equally open for discussion. The general discussion is upon matters relating to policy including a re view and criticism of the administration of the Government and its departments. The members of the Legislature, thus, have opportunity of placing the grievance of the tax payers before the House.

PREPARATION OF THE BUDGET

Estimates are first prepared by local 'officials in various departments, and these estimates are consolidated by the head of each department. These estimates are then consolidated by the Ministers concerned and passed on to the Finance Ministry for scrutiny. The Finance Ministry consolidates all these estimates and prepares the budget for the presentation before the Parliament. A similar procedure is adopted for the preparation of the budget of a State Government for its presentation before the State Legislature.

The Consolidated Fund

There is a Consolidated Fund at the Centre and in each State. All receipts are credited to it and all authorised expenditure is incurred from it. Some items of expenditure are charged or non-votable, while others are votable.

Votable and Non- Votabie Expenditure

The votable expenditure refers to the demands of various ministers for grants. The demand of each ministry is introduced by the Minister incharge of the respective Ministry or by somebody else on his behalf. A demand becomes a grant when it is voted. However, amendment motions can be moved to reduce any grant, but no amendment can be made on such motions.

It should however, be noted that the demands for grants are voted only in Lak Sabha in Centre or Vidhan Sabha in a State respectively.

Non-Votable Hems.

The items which are non-votable are follows:

1. The salary and allowances of the President and other expenditure relating to his office.

2. Salaries and allowances of the Chairman and the Deputy Chairman of Rajya Sabha and the Speaker and Deputy Speaker of the Lok Sabha.

3. The debt charges of the Government of India.

4. Salaries and pensions of the Judges of the Supreme Court.

5. Salaries, allowances and pension of the Comptroller and Auditor General of India.

6. Any sum required to satisfy any judgement decree or award of any Court/arbitral tribunal.

7. Any other expenditure declared by the Constitution or by Parliament by Law to be charged.

The Appropriation Bill

In the Constitution of India, it has been laid-down that no money be appropriated out of the Consolidated Fund "except in accordance with the Law." Hence, Appropriation Bill has to be passed, otherwise the Government is not legally authorised to utilise any amount out of the Consolidated Fund. The Appropriation Bill includes all the grants for the year whether votable or nonvotable. It is moved when the demands for grants have been voted. It gives legal effect to the demands which have been voted by the House. It is, thus obvious, that how Parliament controls public expenditure.

The Finance Bill

It should, however, be noted that the Appropriation Act only authorises the Government to appropriate money from the Consolidated Fund, but the problem of collecting the required money is not solved. As it has been laid down in our Constitution that, "no tax shall be levied and collected except by authority of Law." Thus, to solve this problem a Finance Bill is placed before the House. The Bill when passed becomes the Act, which authorises the Government to collect the required money through taxation or the provisions that have been made in the Budget. This Bill embodies the taxation proposals for the financial year and it includes all the existing taxation schemes, with or without modifications proposed.

However, it should be clearly followed that, a Money Bill relates exclusively to taxation, regulation of borrowing or expenditure, but a Finance Bill contains other provisions besides these. Thus, the scope and range of a Finance Bill is wider than that of a Money Bill,

The budget is said to be passed when Appropriation Bill and Finance Bill are passed. However, every aspect of these is fully discussed in Lok Sabha before they are passed.

After the budget is passed in the Lok Sabha, it then goes to Rajya Sabha. The Rajya Sabha does not enjoy the power of amending or rejecting the budget. The Rajya Sabha can make only recommendations to the Lok Sabha, but within a period of 14 days. The Lok Sabha may either accept the recommendations of Rajya Sabha or reject them.

When the Budget has been passed by both the Houses, it, then goes to the President for his assent. Generally, the President gives his assent because of his very limited powers in this respect.

IMPORTANCE OF PUBLIC BUDGET

The budget in its elementary form had been part of almost all monarchies of the history. There have been written documents regarding the existence of the state treasury, accountants and auditors who were employed by the monarchs to protect the royal treasury. The modern democracies have the legislatures playing an important role in the managing of public finances. The taxes that are collected and the revenues that are generated by the government through several means are to be used for the development and welfare of the society. The emergence of the Welfare State made it important that the government money is being judiciously used to better the living conditions of society in general and the marginalized sections in particular.

*Prioritization of the allocation of the public resources

*Achieving policy goals through prudent financial planning.

*Establishing accountability regarding the usage of the tax payers money

* Financial controls also ensure compliance to rules and increase in efficiency

In some countries, the executive part of the government also plays an important part regarding the revenues and expenditures of the government and the legislative is reduced to just an approving and reviewing authority, e.g. in UK where the budget process is primarily dominated by the executive (the House of Commons). A more balanced approach of distributing power is practiced in the USA where the legislature can review and make changes to the budget presented by the President and the President finally approves it after satisfactory checks and balances are concluded.

The dominance of executive or legislature in the budgeting process is a matter of debate as many consider the legislative to be an obstacle in the fast paced globalized economy where foreign direct investment and monetary funding from organizations like IMF and World Bank is of crucial importance to several democracies. There are several measures suggested to expedite the decision making process from fixing the term of the legislatures, introducing citizen panels, attaching funding power at local levels to bringing in two year budgetary cycle and special legislation regarding expenditure management.

The government expenditure is funded by a common pool of tax payer's money and the policies that are formed with this money are further used to fund projects. The catch here lies in the fact that the people who actually are paying for these policies are the larger group while the people who benefit from these policies might be a much smaller group, which translates that one might not be enjoying the benefits for which one is paying money. Such scenario leads to an excessive spending of public money on policies which are not beneficial to the society as a whole. Such situations are prevalent in democracies which are multi-lingual, multi-ethnic and divided on the basis of regions, religions and other factors.