**FISCAL ECONOMICS Sub Code; 18ECC508**

 **Module--III**

 **Public Expenditure**

### **Meaning of Public Expenditure:**

Expenses incurred by the public authorities—central, state and local self- governments—are called public expenditure. Such expenditures are made for the maintenance of the governments as well as for the benefit of the society as whole.

### **Causes of Increase in Public Expenditure:**

**(a) Size of the Country and Increase in population:**

We see an expansion of geographical area of almost all countries. Even in no-man’s land one finds the activities of the modern government.

Assuming a fixed size of a country, developing world has seen an enormous increase in population growth. Consequently, the expansion in adminis­trative activities of the government (like defense, police, and judiciary) has resulted in a growth of public expenditures in these areas.

**(b) Expansion of State Activities:**The Government in most of the countries took charge of the new activities which required increased expenditure. State activities should be carefully monitored with respect to their necessity, to reduce public burden.

**c) Defense Expenditure:**

The tremen­dous growth of public expenditure can be attributed to threats of war. No great war has been conducted in the second half of the twentieth century. But the threats of war have not vanished; rather it looms large.

**(d) Welfare State:**

The 19th century state was a **‘police state’** while, in 20th and 21st centuries modern state is a **‘welfare state’**. Even in a capitalist framework, socialistic principles are not altogether discarded.

Various socio-economic programmes are undertaken to promote people’s welfare. Modern governments spend huge money for the purpose of economic development. It plays an active role in the production of goods and services. Such investment is financed by the government.

(e) **Economic Planning**: Every economy is trying to be self-sufficient and economically strong. In order to achieve this end, planning has been taken as recourse. Planning involves a large amount of expenditure at its various stage i.e. establishment of a central Planning Machinery (e.g., Planning Commission), formulation of a plan; its execution and evaluation. We can cite the example of economic planning in India and the public expenditure involved therein.

**f) Economic Development:**

Modern government has a great role to play in shaping an economy. Private capitalists are utterly incapable of financing economic development of a country. This incapacity of the private sector has prompted modern governments to invest in various sectors so that economic development occurs.

Economic development is largely conditioned by the availability of economic infrastructure. Only by building up economic infrastructure, road, transport, electricity, etc., the structure of an economy can be made to improve. Obviously, for financing these activities, government spends money.

**(g) Price Rise:**

Increase in government expenditure is often ascribed to inflationary price rise.

## **Classification of Public Expenditure**

The classification of public expenditure can be done in 4 ways:

#### **Revenue Expenditure**

The revenue expenditure is funded through the current revenue of the government that includes taxes and non-tax revenues such as welfare schemes or profits, or incidental incomes.

#### **Capital Expenditure**

The capital expenditure is spent on the construction of public properties such as buildings, bridges, dams, roads, and railways. The extra expenditure is met through internal and external loans.

#### **Development Expenditure**

The development expenditure is used to maintain and improve resources for welfare development such as industrial development, educational institutes, irrigation development, and so on. These resources are meant to improve the quality of life, skill, and productivity of the public.

#### **Non-Development Expenditure**

The non-developmental expenditure is spent on defence, law and order, and civil administration. These are the sources that are responsible for the smooth functioning of a society.

**Canons of public expenditure:**

(i) Canon of benefit

(ii) Canon of economy

(iii) Canon of sanction

(iv) Canon of surplus

#### V].Canon of Elasticity;

#### (i) **Canon of Benefit:**

According to this canon, public spending has to be made in such a way that it confers greatest social benefits. In other words, public expenditure must not be geared in such a way that it provides benefits to a particular group of the community. Thus, public expenditure is to be made in those directions where general benefits rather than specific benefits flow in.

#### (ii) **Canon of Economy:**

Economy does not mean miserliness. It refers to the avoidance of wasteful and extravagant expenditure. Public expenditure must be made in such a way that it becomes productive and efficient. Efficiency in public expenditure requires economy of expenditures. To enjoy the maximum aggregate benefit from any public spending programme, it is necessary that the canon of economy is observed.

#### (iii) **Canon of Sanction:**

The canon of section, as suggested by Shirras, requires that public spending should not be made without any concurrence or sanction of an appropriate authority. Arbitrariness in public spending can be avoided only if spending is approved. Further, economy in public spending can never be ensured if it is not sanctioned.

#### iv). **Canon of Surplus:**

This canon suggests the avoidance of deficit in public spending. Like individuals, saving is a virtue for the government. So the government must prepare its budget in such a way that government revenue exceeds government expenditure so as to create a surplus. It must not run deficit to cover its expenditure.

#### V]. **Elasticity;**

The canon of elasticity maintains that the public expenditure should be flexible. This means that the expenditure should be maintained in a manner that the expenses can be increased or decreased if and when the situation demands so.

**Public expenditure promotes economic development in the following ways**:

• **Social and Economic Overheads** a) Economic overheads like the roads and railways, irrigation and power projects are essential for speeding-up economic development. b) Social overheads like hospitals, schools, and colleges and technical institutions too are essential.

 • **Balanced Regional Growth** a) Special attention has to be paid to the development of backward areas and underdeveloped regions. b) This requires huge amounts for which reliance has to be placed on public expenditure

• **Exploitation and Development of Mineral Resources** a) Minerals provide a base for further economic development. b) The government has to undertake schemes of exploration and development of essential minerals, e.g., coal and oil.

 • **Subsidies and Grants** a) The Central Government gives grants to State governments and the State governments to local authorities to induce them to incur some desirable expenditure b) Subsidies have also to be given to encourage the production of certain goods especially for export to earn much-needed foreign exchange.

### **Importance of Public Expenditure:**

An old-fashioned dictum says that **“The very best of all plans of finance is to spend little, and the best of all taxes is that which is least in amount.”** No one today believes this philosophy. In the 1930s, J. M. Keynes emphasized the importance of public expenditure.

The modern state is described as the **‘welfare state’**. As a result, the activities of the modern government have widened enormously. Modern governments are undertaking various social and economic activities, particularly in less developed countries (LDCs).

#### **Economic Development:**

Without government support and backing, a poor country cannot make huge investments to bring about a favourable change in the economic base of a country. That is why massive investments are made by the government in the development of basic and key industries, agriculture, consumable goods, etc.

A developing country like India must undertake various projects, like road-bridge-dam construction, power plants, transport and communications, etc. These social overhead capital or economic infrastructures are of crucial importance for accelerating the pace of economic development.

#### **ii. Fiscal Policy Instrument:**

Public expenditure is considered as an important tool of fiscal policy. Public expenditure creates and increases the scope of employment opportunities during depression. Thus, public expenditure can prevent periodic cyclical fluctuations. During depression, it is recommended that there should be more and more governmental expenditures on the ground that it creates jobs and incomes.

#### **iii. Redistribution of Income:**

Public expenditure is used as a powerful fiscal instrument to bring about an equitable distribution of income and wealth. There are good much public expenditure that benefit poor income groups. By providing subsidies, free education and health care facilities to the poor people, government can improve the economic position of these people.

#### **iv. Balanced Regional Growth:**

Public expenditure can correct regional disparities. By diverting resources in backward regions, government can bring about all-round development there so as to compete with the advanced regions of the country.

Public expenditure has both economic and social objectives. It is necessary to ensure that the government’s expenditure is made solely in the public interest and does not serve any individual’s interest or that of any political party or a group of persons.

# Difference between Public and Private Expenditure

#### Public expenditure is similar to private expenditure in some respects. But in many other respects, it is quite dissimilar to private expenditure. Similarities and dissimilarities 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 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](http://www.economicsdiscussion.net/articles/differences-between-public-and-private-finance-discussed/1934)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](https://www.knowledgiate.com/reasons-for-increase-in-public-expenditure/) is much more the 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.

## **The Effects of Public Expenditure**

According to economist [Hugh Dalton](https://en.wikipedia.org/wiki/Hugh_Dalton), public expenditure affects the economy in three main areas. These include production, distribution, and stabilization.

#### **1. Production**

Public expenditure affects production based on one’s potential to work and save, the inclination to work and save, and the smart utilization of resources.

* **Potential to Work and Save**

Public Expenditure provides economic resources that promote work among people. This leads to efficiency and an increase in production, which in turn provides a gateway for the public to save their income for an investment for a better future.

* **The Inclination to Work and Save**

If the government spends a considerable amount on providing better resources, it would encourage people to access those resources and work towards a goal. This inclination would promote production for a desire for a better lifestyle.

* **The Utilization of Resources**

The government would thus be investing in resources where the production creates maximum value. This would encourage the unproductive resources to work along with the productive resources to create more opportunities for them. This would lead to increased production value.

#### **2. Distribution**

Public expenditure aims at working towards equal distribution of resources to all sections of the society. The government achieves this by collecting funds from the sections of the society that benefit from their high incomes in the form of taxes. These funds are then used to provide basic resources and to promote growth and employment for the other sections of the society.

The government promotes growth by providing resources such as healthcare, infrastructure, and education. They promote small scale industries and encourage the public sector to employ more people at higher wages. Lastly, the government also helps the weaker sections of the society by allowing them to avail loans at low-interest rates.

**Effects of Public Expenditure on Distribution:**

1. **Social Security Measures:**

Expenditure on unemployment insurance, sickness benefits, old age pensions is some of the social security measures which help the people at times of contingencies. In India only in recent years some State Governments such as those of Haryana, Punjab, Delhi have introduced old age pension scheme. In capitalist countries such as U.S.A., Great Britain the social security system to help the people emerged with the idea of a Welfare State and in these countries Governments spend a large sum of money on the social security system.

1. **Expenditure on Subsidies:**

Expenditure on various types of subsidies has also a redistributive effect. In India subsidies on food-grain, sugar, kerosene oil, handloom cloth, fertilizers are provided to the people and Government spend a good part of its budget on these subsidies.

Food-grain, sugar, kerosene oil are sold through ration shops (i.e., public distribution system) at prices below the market prices and the difference is borne by the Government as a subsidy. It may be noted that at present benefits of these subsidies are enjoyed not only by the poor but all those who are relatively well off. If the public expenditure on subsidies is to have a real redistributive effect, these subsidies should be targeted to the poor.

1. **Expenditure on Social Infrastructure:**

Public expenditure by the Government on so­cial infrastructure such as education, health care of the people, housing for the poor also tend to reduce income inequalities. With free or subsidised education, free or highly subsidised health care facilities the poor people’s real income go up.

The modern govern­ment spends a lot of money on schools, colleges, etc., to promote education. In most states in India education upto the middle class is free and for higher levels wards of the poor people are either given free education or charged only low fees.

Having studied the causes of large increase in public expenditure, it will be useful to explain the effects of public expenditure on the production and distribution in the economy. Public expenditure, if properly allocated and efficiently used, can have a wholesome effect on the economy.

Public expenditure can augment productive capacity of the economy and improve productivity of its working class. It can also reduce inequalities in income distribution, if properly designed. In the following we shall spell out in detail the impact of public expenditure on production and income distribution in the economy.

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#### **3. Stabilization**

The government works towards economic stability by keeping a balance by controlling inflation and deflation. They have to ensure that there are enough resources in stock in case there are cases of depression in the economy.

British economist John Maynard Keynes believed that public expenditure can work in times of depression. Public expenditure leads to demand which would increase employment opportunities on the part of production companies and thus lead to a balanced demand-supply chain..

**Expenditure on Anti-Poverty Programs:**

An important step for increasing incomes of the poor people is starting of several employment generating anti-poverty schemes. Prominent among these anti-poverty schemes in India are Jawahar Rozgar Yojna, Employment Assistance Scheme (EAS), and Integrated Rural Development Programme (IRDP).

Recently in India, employment guaran­tee scheme under National Rural Employment Guarantee Act (NREGA) has been started which greatly help the rural poor. By generating employment these schemes raise incomes of the poor.

**Encouragement to Labour-intensive Industries:**

The Indian Government gives various types of subsidies to the cottage and small-scale Industries which adopt labour-intensive technique. Being labour-intensive, the growth of these industries generates a large number of employment opportuni­ties which improve income distribution.

**Negative Income Tax to Achieve More Equal Distribution of Income:**

Last but not the least, to achieve more equal distribution of income and make a big dent into the poverty problem, a pro­posal which has been recently put forward by some economists in the USA and Great Britain is introduction of negative Income Tax.

But the use of public expenditure to reduce inequalities in income distribution has certain bad effects also. The first and foremost evil effect is that it adversely affects incentives to work and save of the people. Thus, when people know that in times of difficulties such as unemployment, old age, sickness, the Government will come to their help they will be less willing to work hard.

**EXPENDITURE CONTROL FRAMEWORK**

1. **Authorization for Public Expenditure** • Limit on amount of expenditure. Government’s expenditure must be within the amounts that the budget appropriations have established, with some flexibility allowed through varmints and contingency reserve mechanisms. The nature of those expenditure limits depends on the accounting basis (cash, commitment, or accrual) used in the budget.

 • Limit on time horizon of expenditure. The expenditure must occur within the time limits applicable to the expenditure authorization. Most countries adopt annual budgets authorizing spending for one year; however, some countries authorize multi-year limits for certain types of expenditure.

• Authorized purpose of the expenditure. The authority for expenditure is given for a specific pre-defined purpose. The budget classification (which may be organized by programs, sub-programs, projects, economic categories, or line items) usually specifies the purpose for which the expenditure can be made.

• Administrative unit accountable for expenditure. A unit of government, typically a line ministry, department or agency, is assigned the responsibility to ensure that the appropriated resources are spent as intended within the authorized limits.

1. **Apportionment of authorization for specific periods and spending units.**

Once expenditure authorization is in place, it is apportioned for specific periods and/or specific spending units. Apportionment usually follows two steps: (i) apportionment by the ministry of finance, which consists of releasing the appropriation on a quarterly or monthly basis to the line ministries; and (ii) allotment by the line ministries or main spending units of their apportioned appropriations to their subordinate spending units.

1. Reservation. Once the apportionment of expenditure authorization is made and the spending authority has been released,
2. 4. Commitment. The commitment stage is the point at which a potential future obligation to pay is established. A commitment occurs when a formal action, such as placing an order or awarding a contract, is taken that renders the government liable to pay at some time in the future when the order or contract is honored by its counterpart.
3. 5. Verification (or certification). At this stage, after goods have been delivered and/or services have been rendered by a supplier, an authorized officer within the spending unit concerned verifies their conformity with the contract or order, and that a liability and due date of payment are recognized.
4. Payment order. Once checks are made to ensure that all previously stipulated controls have been performed and documented, a payment order is issued. A payment order is an authorization for payment made by officials of line ministries, other spending agencies, or the ministry of finance. Before issuing a payment order, the issuing authority will typically check that sufficient funds are available to make the payment.
5. Payment. Once a payment order has been issued, payments are made through various instruments including checks, electronic fund transfer (EFT), and sometimes cash, in favor of a supplier or other recipient to discharge the liability.

#  Budget

**Definition:** A budget is a formal statement of estimated income and expenses based on future plans and objectives. In other words, a budget is a document that management makes to estimate the [revenues](https://www.myaccountingcourse.com/accounting-basics/revenue-accounts) and [expenses](https://www.myaccountingcourse.com/accounting-basics/expense-account) for an upcoming period based on their goals for the business.

A budget is a blueprint of plan of action to be followed during a specified period of time for the purpose of attaining a given objective.

### **Features:**

**An analysis of the above definition reveals the following essential features of a budget:**

(i) It is prepared beforehand based on a future plan of actions;

(ii) It is related to a definite future period and is based on the objectives to be attained;

 (iii) It is expressed in financial terms;

(iv). It shows planned income to be generated;

(v). It shows probable expenditure to be incurred;

(vi). It indicates the capital to be employed during the period;

## Classification of Budget

**Budgets classified according to 4 bases;**

1. Based on Time;
2. Based on Condition;
3. Based on Functions; and,
4. Based on Flexibility.

## **Types of Budget Based on Time**

Based on time factor budgets can be classified into two types;

1. Long-term Budget, and
2. Short-term Budget.

## **Long-term Budget**

This budget is related to the planning operations of an organization for a period of 5 to 10 years. The long-term budget may be adversely affected due to unpredictable factors. Therefore, from a control point of view, the long-term budget should be supplemented by short-term budgets.

Example: Research and Development Budget, Capital Expenditure Budget, etc.

## **Short-term Budget**

This budget is drawn usually for one year. Sometimes a budget may be prepared for a shorter period (like monthly budget, quarterly budget, etc.). Short­term budgets are prepared in detail and these budgets help to exercise control over day-to-day operations.

Example: Material Consumption Budget, Labor Utilization Budget, Cash Budget, etc.

## **Types of Budget Based on Condition**

Based on conditions prevailing, a budget can be classified into 2 types;

1. Basic Budget, and
2. Current Budget.

## **Basic Budget**

A budget that is established for use as unaltered over a long period is called Basic Budget.

This budget does not take into consideration changes occurring from the external environment which are beyond the control of management. This budget is more useful for top-level management for formulating policies.

## **Current Budget**

A budget that is established for use over a short period and is related to the current conditions is called the Current Budget. This budget is adjusted to the current conditions prevailing in the business.

## **Types of Budget Based on Functions**;

Based on activities or functions of a business, budgets can be classified into 2 types

1. Master Budget, and
2. Functional Budgets.

## **Master Budget**

The final integration of all functional budgets by the Budget Officer provides the Master Budget. When functional budgets have been completed, the Budget Officer prepares the Master Budget.

Master Budget is the summary budget incorporating its component functional budgets, which is finally approved, adopted and employed. [C. I. M. A. (London)l.

Master Budget shows the operating profit of the business for the budget period and budgeted balance sheet at its close. This Budget portrays the overall plan for the budget period.

## **Functional Budgets**

Functional Budgets relate to functions of the business such as product sales etc. In other words, Functional Budgets are prepared in respect of various functions performed in a business.

Functional Budgets which are commonly found in a business concern are as follows;

1. Sales Budget;
2. Production Budget;
3. Material Budget;
4. Labor Budget;
5. Production Overhead Budget;
6. Administration Overhead Budget;
7. Selling & Distribution Overhead Budget;
8. Plant Utilization Budget;
9. Cash Budget
10. Research & Development Budget and more.

**BALANCED BUDGET**

A government budget is said to be a balanced budget if the estimated government expenditure is equal to expected government receipts in a particular financial year. Advocated by many classical economists, this type of budget is based on the principle of “living within means.” They believed the government’s expenditure should not exceed their revenue.

Though an ideal approach to achieve a balanced economy and maintain fiscal discipline, a balanced budget does not ensure financial stability at times of economic depression or deflation. Theoretically, it’s easy to balance the estimated expenditure and anticipated revenues but when it comes to practical implementation, such balance is hard to achieve.

MERITS OF A BALANCED BUDGET

1. Ensures economic stability, if implemented successfully.

2. Ensures that the government refrains from imprudent expenditures.

3. Unviable at times of recession and does not offer any solution to problems such as unemployment.

4. Inapplicable in less developed countries as it limits the scope of economic growth.

5. Restricts the government from spending on public welfare.

### **Importance balanced budget**

Planning a balanced budget helps governments to avoid excessive spending and allows them to focus funds on areas and services that require them the most. Furthermore, achieving a budget surplus can provide funds for emergencies, e.g., if the government wishes to increase spending during a recession without having to borrow.

Balancing the budget also allows governments to save on the interest rate charges that accrue on large loans from lenders (i.e., other countries and/or organizations like the [International Monetary Fund (IMF)](https://www.imf.org/external/index.htm) and the World Bank) and to have control over policies during times of distress.

 **SURPLUS BUDGET**

A government budget is said to be a surplus budget if the expected government revenues exceed the estimated government expenditure in a particular financial year. This means that the government’s earnings from taxes levied are greater than the amount the government spends on public welfare. A surplus budget denotes the financial affluence of a country. Such a budget can be implemented at times of inflation to reduce aggregate demand.

**Effects of Budget Surplus**

### **1. Impacts Growth**

If the government is bringing in more money than it’s spending, the question arises – where is the surplus going? Well, it might be spent to reduce existing debt, or, more likely – future government spending. Either way, it is money taken away from the private sector and the wider economy.

### **2. Declining Government Debt**

If governments decide to use the surplus, they may wish to reduce its debt burden

### **3. Lower Interest Rates**

When governments post a surplus, it means debt levels can be reduced. In turn, it makes lending to government less risky. If government has lower levels of debt, it is less likely to default.

### **4. Deflation**

Going from a budget deficit to a budget surplus may cause [**deflation**](https://boycewire.com/deflation-definition-causes-and-effects). This is because it would provide a negative pull on aggregate demand. We can look at this from two angles.

First of all, if the budget surplus is a result of reduced government spending, there is less money being spent in the wider economy. So overall demand may decline if this is the sole cause – thereby creating deflationary pressure.

Second of all, if the surplus comes from higher taxes, it means businesses and consumers have fewer funds to spend and invest. In relation to the wider economy, this means reduced demand for goods and services.

### **5. Lower Quality Public Services**

If the budget surplus arises from a decline in government spending; it means there are fewer funds for publicly provided goods. For instance, if government spends less, it must choose where to cut spending from.

**Advantages of Budget Surplus**

Receiving more than you spend is simple economics, yet many countries choose instead to spend their way out of recessions and to drive new economic growth.

### **1. Fights Inflation**

On occasion, the economy can ‘heat up’; causing high levels of [**inflation**](https://boycewire.com/what-is-inflation). During periods of high economic growth, we may see strong price increases. Although inflationary pressures can also occur during periods of economic decline.

### **2. Fiscal Flexibility**

Having a budget surplus allows governments the room to maneuver. Having a surplus in one year is not going to give much flexibility, but one over a period of time will.

### **3. Low Interest**

When a nation has a large budget surplus, it means that it doesn’t need to borrow so much money. It can pay off its existing debt, thereby reducing its overall burden. As a result, the risk of the nation defaulting on its debt also reduces, which encourages more investors to purchase government debt – as it is a safe investment. Interest rates decline as there is more demand for government debt than there is from the government to supply this debt – so investors are willing to take a lower rate.

### **4. Reduces Government Debt**

When a government has a budget surplus, it can do many things with the excess cash that it accumulates. Usually, this will be used to reduce existing debt that accumulated during periods of a budget deficit. This helps the nation reduce its debt burden and increase its global standing as a reliable debtor.

**Disadvantages of Budget Surplus**

A budget surplus might seem like sensible economics, but doesn’t come without its disadvantages to the wider economy:

[**Lower levels of Investment**](https://boycewire.com/budget-surplus-definition/#Lower-levels-of-Investment)

A budget surplus means that the government is taking more from the economy that it is putting in. In other words, it is starving the economy of money.

[**Deflationary Effect**](https://boycewire.com/budget-surplus-definition/#Deflationary-Effect)

When government operates a budget surplus, it is removing money from circulation in the wider economy. With less money circulating, it can create a deflationary effect.

[**Economic Decline**](https://boycewire.com/budget-surplus-definition/#Economic-Decline)

Government spending is a component of [**GDP**](https://boycewire.com/what-is-gdp). So when it is taxing more than its spending, it is effectively taking money away from the wider economy. If this isn’t being spent, it is just sitting there doing nothing – when instead it could be used by private firms to invest in new and productive capital equipment.

**DEFICIT BUDGET**

A government budget is said to be a deficit budget if the estimated government expenditure exceeds the expected government revenue in a particular financial year. This type of budget is best suited for developing economies, such as India. Especially helpful at times of recession, a deficit budget helps generate additional demand and boost the rate of economic growth. Here, the government incurs the excessive expenditure to improve the employment rate. This results in an increase in demand for goods and services which helps in reviving the economy. The government covers this amount through public borrowings (by issuing government bonds) or by withdrawing from its accumulated reserve surplus

**MERITS OF A DEFICIT BUDGET**

Helps in addressing public concerns such as unemployment at times of economic recession.
Enables the government to spend on public welfare.

**DEMERITS OF A DEFICIT BUDGET**

Can encourage imprudent expenditures by the government.
Increases burden on the government by accumulating debts.

**Types of Deficit Budget**

**Revenue Deficit:**

Revenue Deficit is the excess of its total revenue expenditure to its total revenue receipts. Revenue Deficit is only related to revenue expenditure and revenue receipts of the government.

**Fiscal Deficit:**

The excess of total expenditure over total receipts excluding borrowings is called Fiscal Deficit. In other words, the Fiscal Deficit gives the amount needed by the government to meet its expenses. Thus a large Fiscal Deficit means a large amount of borrowings.

**Primary Deficit:**

Primary Deficit is Fiscal Deficit of the current year minus interest payments on previous borrowings. While Fiscal Deficit represents the government's total borrowing including interest payments, Primary Deficit shows the amount of borrowing excluding interest payments.

**Zero-based budgeting**

Zero-based budgeting is a method of budgeting in which all expenses for each new period must be justified. Under zero-based budgeting, no reference was made or considered of previous years. The budget request has to be evaluated thoroughly with its commencement from the zero-base.

**Evolution of zero-based budgeting (ZBB)**

The Zero-based budgeting concept was advocated in 1924 by British budget authority Edward Hilton Young. He advocated complete justification of every item requested in a budget.

**Zero-based budgeting in India**

In India, the principle of ZBB was initiated in the Department of Science and Technology in 1983. In 1986, the Indian government adopted ZBB as a technique for determining expenditure budget. The government made it mandatory for all ministries to review their programs and activities and prepare their expenditure estimations based on ZBB concept. In seventh five-year plan, the ZBB system was promoted. However, later not much progress happened in this area.

**Features of zero-based budgeting**

##### **Zero-base**

ZBB works on the principle that every year, the projected expenditure for each project/programs must be start from zero. It means all budget requests should be considered freshly for every year with cost-benefit analysis.ZBB never uses the previous year’s amounts so as to eliminate the past mistakes.

##### **Focus is on activities/programs**

The focus is on programs or activities instead of functional departments.

##### **Best suited to discretionary costs**

ZBB is best suited to discretionary costs, for example, advertising, research development and training costs.

##### **Decision packages**

A unit makes its budget request by preparing ‘decision packages’ for each activity it undertakes. Funding decisions are based on activity.

##### **Cost-effective**

ZBB helps policy makers to achieve more cost-effective delivery of public services.

##### **Bottom-up approach**

ZBB starts from the lowest level activity and then moves upwards

##### **Accountability**

It makes the functionaries accountable for the amount they are responsible for.

ZBB model was formulated to correct certain flaws of traditional budgeting system, which does notallow authorities to discover optional processes.

**Conditions for successful implementation of ZBB**

There are a few conditions for successful implementation of ZBB.

**Committed Management:**The top management should have a participatory role and they must be committed to implement the ZBB.

**Fixed Goals:**Goals to be achieved must be fixed. They should not be vague. **Identification of Weak areas:**Organization must identify weak areas to be worked upon.

**Trained Staff:**ZBB requires a trained staff for its procedure to be implemented properly.

**Review:**Decision packages must be reviewed periodically.

**Brainstorming Sessions:**There must be brainstorming sessions at all hierarchical levels to get proper and timely feedback.

**Need for zero-based**

#### Lowbudgeting priority programs can be eliminated or reduced.

* Effectiveness of programmes can be dramatically improved.
* Programmes of high priority can obtain increased funding by shifting resources within an agency.
* The government need not increase the tax revenue as ZBB can to do a more effective job with existing revenues.

**Benefits of zero-based budgeting**

**Unbiased:**The bias from previous information or datais eliminated.

**Higher motivation:**ZBB seeks employees to work more cohesively and closely together during the budget process. This results in high levels of motivation and interest among employees to do their work efficiently.

**Effective Procedures:**Zero-based budgeting will generate effective ways and methods to do the work.

**New Ideas:**Inzero-based budgeting new technologies, methods and materials are encouraged to make the organisation more successful.

**Efficient Allocation of Resources:**By following cost-benefit analysis ZBB will allocate the resources very efficiently.

**Planning Tool:**ZBB is a planning tool used in management which helps in identification of wasteful and redundant items of expenditure.

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