Other non-tax revenue refers to revenue from fiscal services (profits from circulation of coins), social services (receipts from commercial offences and services), economic services (receipts from animal husbandry, fisheries, transport and communications, tourism etc), general services (examination fee of UPSC, sale of forms, passport fees, visa fees etc) and grants-in-aid (cash grants-in-aid from foreign countries and international organizations).

Revenue expenditures relate to the normal running of the government and interest payment on government debts. These expenditures do not create any physical or financial assets. Indian budget documents classify revenue expenditure into plan and non-plan revenue expenditure.

Plan revenue expenditure pertains to Central Plan and Central assistance provided for state and union territory plans. Such expenditure meets financial requirement of the development plans at the central and state levels. It includes plan assistance for the development of agriculture, rural development, irrigation and flood control, industry and mineral, transport, communications, science and technology both at central and state levels.

Non-plan revenue expenditure comprises of a wide range of general, social and economic services of the government. Expenditure on general services include administrative expenses of Parliament, the President and Council of Ministers, tax collection, interest payments, administrative services etc. Social services expenditure includes expenditure on education, arts and culture, science and research, medical services, family planning, public health, information and broadcasting, labour and employment, social security and welfare. This expenditure head becomes necessary as it assists in improving the quality and productivity of general population. Economic services comprises of expenditure on agriculture, irrigation, industrial and minerals, foreign trade and export promotion, animal husbandry, dairy development, fisheries, forestry, community development, industry and minerals, water and power development, transport and communications. The three main items of non-plan expenditure of the government are interest payment, pensions and subsidies.

Capital Budget

Capital budget cover capital receipts and capital expenditures of the government as explained below:

Capital receipts are the receipts of the government which create liability or reduce financial assets. The main components of such receipts are borrowings of different types and repayment of loans and advances by other parties. Important capital receipts are – market loans, special deposits, external assistance, recovery of loans and advances, small savings and provident funds.

Market loans are the loans floated by the government in money and capital markets. These are calculated on net basis, i.e., gross borrowing less repayment of loans.

Special deposits are investments with the government by the non-government provident funds, gratuity funds and investment surplus funds of LIC, GIC, and Employees' State Insurance Corporation etc.

External assistance is the loan received from foreign countries and international organizations.

Recovery of loans and advances refer to the recoveries of loans and advances made by the central to the state governments and union territories, foreign governments, industrial undertakings, municipalities, cooperative societies, companies in the private sector and government employees.

Small savings is another important type of capital receipts. These include post saving accounts,

time and recurring deposits with post offices, Kisan Vikas Patra, National Saving Certificates etc.

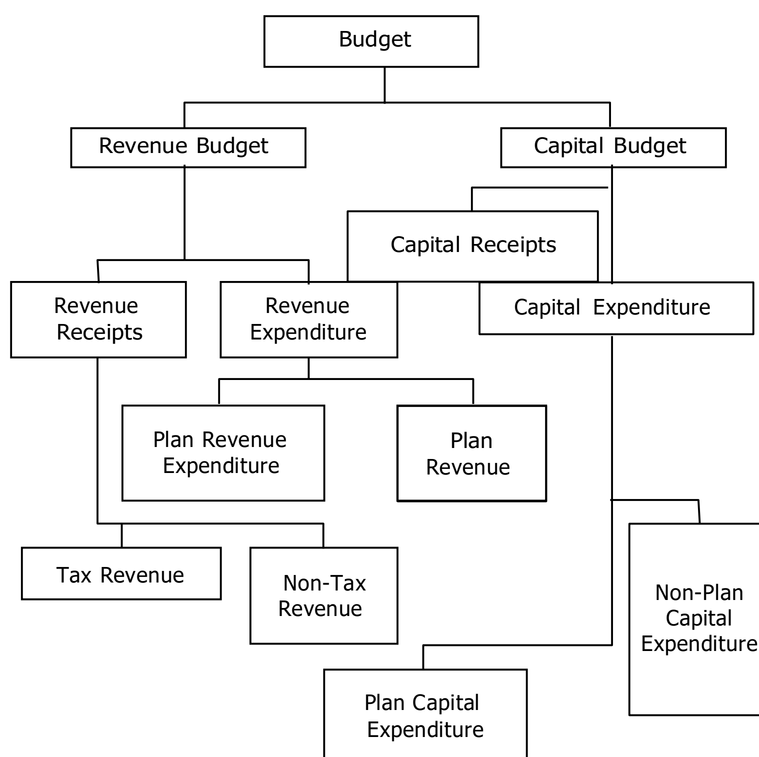
Provident funds include State Provident funds and Public Provident Funds.

Capital expenditures are those expenditures of the government which results in the creation of physical or financial assets or reduction in financial liabilities. Such expenditures are incurred on acquisition of physical and financial assets, such as land, buildings, machinery, equipment, shares and in granting loans and advances to the state governments and public enterprises etc.

Budget documents classify capital expenditure into plan and non-plan capital expenditures. *Plan capital expenditure* relates to the expenditure of the central government on projects included under the central plan. It also includes assistance provided by the central government to the state governments and union territories to meet the financial requirements of their plan projects. This expenditure helps in economic development of the country.

Non-plan capital expenditure various general, social and economic services provided by the government. General services include capital expenditure on defence and civil services such as expenditure on office and administrative buildings, construction works for defence purposes and machinery and equipment for defence. Social and community services include expenditure on buildings of schools, technical institutions, scientific research, hospitals, etc. Economic services consists of expenditure on various schemes of economic development such as agriculture, industry and minerals, power development, roads and bridges etc.

The components of budget are summarized in the schematic representation as under:



OBJECTIVES OF BUDGET

The objectives of a budget can be explained as below:

1. To make definite planning with regard to the estimated revenue and proposed expenditures and disbursements under various heads.
2. To take decisions regarding taxation, borrowings, expenditures and other fiscal measures systematically.
3. To identify various operations of the government and to judge the performance in regard to economic development.
4. To make an instrument of achieving various objectives of economic policy such as maintaining of economic stability and preventing business fluctuations.
5. To act as an index of government functioning.
6. To manage public enterprises effectively.

BALANCED BUDGET AND UNBALANCED BUDGET

A budget can be balanced or unbalanced. According to Dalton, *"a balanced budget is that, over a period of time, revenue does not fall short of expenditure. If expenditure exceeds revenue, the budget is said to be unbalanced."*

In other words, a budget is balanced when government's tax revenue and expenditure are equal. Thus, in case of balanced budget:

$$\text{Revenue} = \text{Expenditure}$$

SURPLUS BUDGET AND DEFICIT BUDGET

When a budget shows that government income and expenditure are not equal, it is said to be an unbalanced budget. This imbalanced may be due to an excess of expenditure over income or an excess of income over expenditure. In the former case, it results in deficit budget and in the latter case, a surplus budget. Thus, excess of income over expenditure is called a surplus budget. A surplus budget decreases liabilities of the government. Hence, in case of surplus budget:

$$\text{Revenue} > \text{Expenditure}$$

A surplus budget is undertaken mainly to curtail the excess expenditure in the economy. When government revenue is more than expenditure, something is taken out of the stream of spending of the community, and this, in turn, reduces national income and total demand via multiplier effect. Thus, a surplus budget is brought under action when there is acute inflation in the economy. A surplus deficit can be brought by decreasing government expenditure or by increasing taxation or by both actions.

The excess of expenditure over income is called a deficit budget. The amount of deficit is covered either through public borrowing or by drawing money from the accumulated surplus with the government. Thus, a deficit budget increases liabilities of the government. Therefore, in case of deficit budget:

$$\text{Revenue} < \text{Expenditure}$$

When level of economic activity is to be raised in the economy, deficit budget is undertaken. A deficit budget raises the level of expenditures and total demand through multiplier effect. Thus, national income is also raised. However, the condition is that the economy should be working below full employment level; otherwise, deficit budgetary policy will add to inflationary pressures in the economy. A budget deficit can be held by increasing government expenditure or by reducing taxation or by both actions. When government increases expenditure, (the revenue remaining same) total spending also increases and through multiplier effect, aggregate demand in the economy increases. When government reduces tax rates or abolishes certain taxes, disposable income of the community increases which stimulates spending, thereby leading to increase in aggregate demand.

TYPES OF DEFICIT

There are four types of deficits. These are: Budget deficit, fiscal deficit, primary deficit and revenue deficit. *Budget deficit* is the difference between (*a*) total expenditure and (*b*) current revenue and net internal and external capital receipts of the government. *Fiscal deficit* is the difference between (*a*) the total expenditure of the government and (*b*) the revenue receipts plus those capital receipts which are not in the nature of borrowing. *Primary deficit* is the difference between fiscal deficit and interest payments. The revenue deficit is the excess of government's revenue expenditures over revenue receipts.

Questions for Review

1. What do you mean by a budget? Explain its importance.
2. What is a revenue budget?
3. Define capital budget.
4. What is corporate tax?
5. Give two sources of non-tax revenue of the central government.
6. State three sources of capital receipts of the central government.
7. What is personal income tax?
8. Define balanced budget.
9. Define surplus budget.
10. Define deficit budget.
11. What are the revenue items?
12. Define tax and non-tax revenue.
13. What is the difference between revenue budget and capital budget?
14. Differentiate between developmental and non-developmental expenditure.
15. What is non-plan expenditure?
16. How may a deficit be financed?
17. What are three levels at which the budget impacts the economy?

FOREIGN EXCHANGE RATE—MEANING AND DETERMINATION

Foreign exchange rate and balance of payments are very closely related. In fact the foreign exchange rate is a mirror reflection of the balance of payments position of a country. Foreign exchange is a term used for foreign money which is internationally acceptable by all the countries. For instance, rupee is our national currency whereas dollar is the foreign currency. It is worthwhile to note that all currencies of the world are not acceptable as a means of settling international trade obligations. U.S. dollar, which is a powerful currency in the world is however internationally acceptable. Let us explain the concept of foreign exchange rate by taking an example of two countries—India and U.S.A. Suppose India buys capital goods from the U.S.A for a certain value. India is required to pay the price of capital goods in terms of dollar and not in terms of rupee, which is not accepted internationally. Thus there is need of conversion of Indian rupee into U.S. dollar for settling the above transaction. To convert rupee, our national currency, into dollar, foreign currency; there must be a price set between the two currencies. The price of one currency in terms of another currency is called foreign exchange rate. In other words, foreign exchange rate is the amount of national currency that must be paid per unit of foreign exchange. For example, if a machine costs Rs. 200000 in India and $ 5000 in U.S.A, then the exchange rate between India and U.S.A will be $1= Rs. 40 or Re. 1= $ 0.025.

The foreign exchange rate is determined by the demand for and supply of foreign exchange as explained in the next section.

Demand for Foreign Exchange

We demand foreign exchange to perform the following balance of payments transactions:

1. to buy foreign goods and services,
2. to make unilateral transfer payments,
3. to make deposits in overseas banks,
4. to make short and long term lending to foreign residents, firms and governments.

The demand for foreign exchange is, thus, derived from our demand for foreign goods and service imports and capital exports. In other words, the demand for foreign exchange emerges due to debit transactions in the balance of payments current and capital account. The demand curve for foreign exchange is sloping downward to the right, which means that as the foreign

exchange rate falls, i.e., as the value of rupee in terms of dollars come down, the domestic importers find it cheaper to buy rupee because they will now have to pay less and less dollars for buying one unit of rupee. The demand of rupee, thus, increases which means increase in the demand for imported goods and services. In other words, as the price of rupee goes down, demand for it goes up and vice versa.

Supply of Foreign Exchange

Supply of foreign exchange consists of foreign money earned by export of various goods and services, receiving unilateral payments from abroad and short term and long term capital inflows. The supply of foreign exchange, therefore, is derived from the credit transactions in the balance of payments current account and capital accounts of a country.

In short, all the foreign receipt i.e., earnings and borrowings constitute foreign exchange supply and all the foreign payments i.e., spending and lending consists of demand for foreign exchange. It is not necessary that foreign exchange supply will always be equal to foreign exchange demand. This can happen when the balance of payments is in equilibrium i.e., when the sum of autonomous current and capital account receipts are exactly equal to the autonomous current and capital account payments. The exchange rate that prevails in the foreign exchange market at the balance of payments equilibrium is called the equilibrium foreign exchange rate. The supply curve of foreign exchange is positively sloping, which means as the value of rupee goes up, the amount of dollars with exporters for each rupee increases. This would encourage domestic exporters to export more goods and services to the foreign countries. This would bring about an increase in the supplies of rupee. Thus, as the price of rupee rises in relation to dollars, exporters sell more abroad, and the country would receive more supply of rupee.

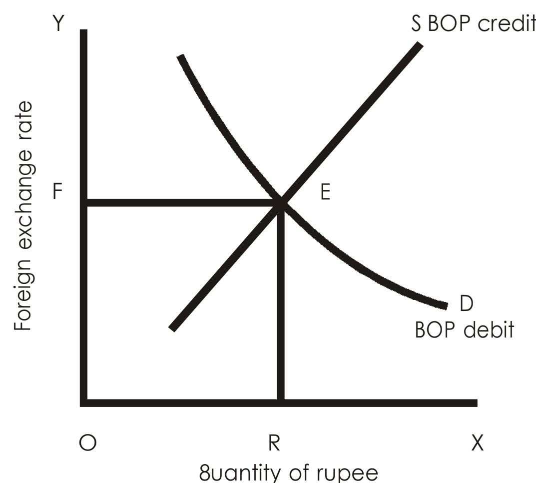


Fig. 26.1

Foreign exchange rate determination with the help of demand and supply forces is shown in the Fig. 26.1. The demand curve for foreign exchange is D, which represents autonomous debit transactions in the balance of payments. All autonomous credit transactions are depicted in the figure by the supply curve of foreign exchange S. At point E, the two curves intersect each other