SARRTHI IAS

ECONOMY

FOUNDATION MODULE

FOR UPSC CSE

BY DR. SHIVIN CHAUDHARY SIR

BUDGETING AND FISCAL POLICY



Recapitalisation of Banks.

Banks → need capital.
- debt
- equity.

govt → can give money directly
- Budgetary support
- extrabudgetary support

Govt → Recapitalisation Bonds.
- Borrows Money from Banks.
- use this money to infuse capital into Banks.

Govt → 0% Risk → No RWA.
0% provisioning.

Reforms in Banking System

- improve credit culture → so No NPA problem again
- improve → Risk assessment framework. → Increase distance b/w Banks ↔ Govt.

Proposal → transfer holding of govt in banks → BHC.

temporary arrangement → Bank Board Bureau.
- Less govt interference.
- appointments in PSB

Now → BBB replaced by Financial Services Institutions Bureau

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Government Budgeting

→ Refer POLITY → Parliament Chapter.

Budgeting

Budgeting means accounting for the future

- planning on the source of income
- Planning on the expenditure in future.

The govt. needs to plan

↓

It needs authorisation from the Parliament. → get authorisation in advance.

Article 114(3)

(3) Subject to the provisions of articles 115 and 116, no money shall be withdrawn from the Consolidated Fund of India except under appropriation made by law passed in accordance with the provisions of this article.

Article 112

Article 112 in Constitution of India

112. Annual financial statement

→ expected credits and debits.

(1) The President shall in respect of every financial year cause to be laid before both the Houses of Parliament a statement of the estimated receipts and expenditure of the Government of India for that year, in this Part referred to as the "annual financial statement".

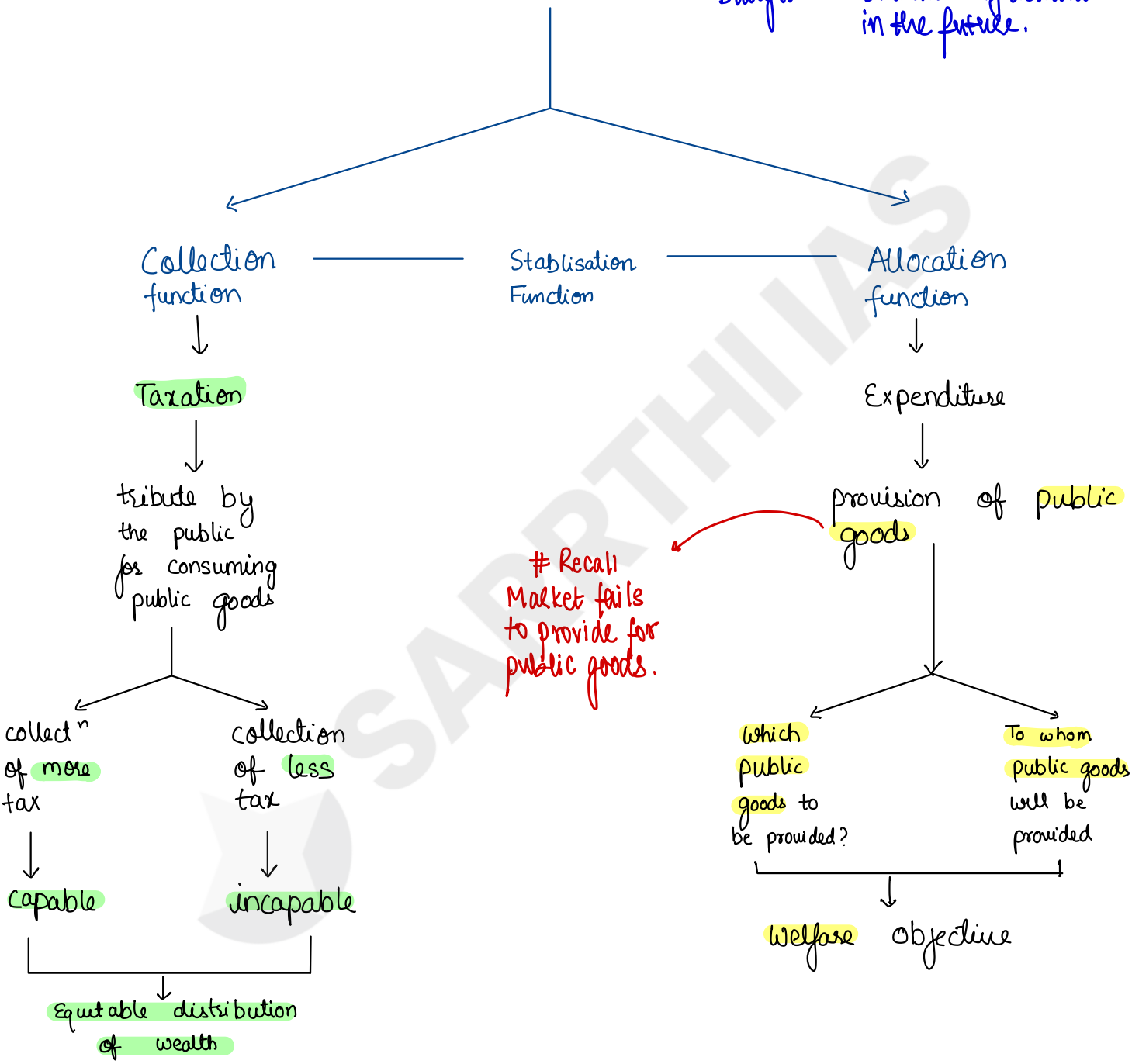
The word 'Budget' is not mentioned in the Constitution.

When this authorization is done in advance? ⟹ It is called 'Budgeting Exercise'

Why there is a need of Parliamentary approval ?

Parliament performs some functions through this exercise

Budget → Statement of accounts in the future.



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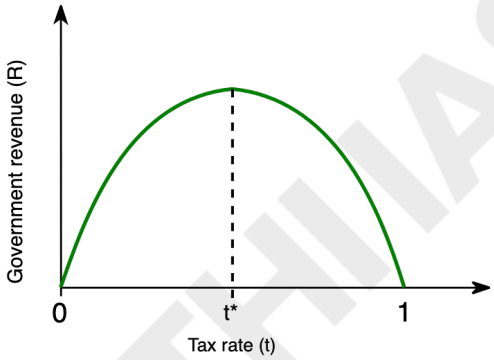
Stabilization function

Tax Collection → If very high → people : less willing to pay taxes.
→ less incentive to work → unemployment
→ If very low → Low tax collection.

Laffer Curve →



Expenditure → If high → too much money in economy → inflation

From the magnitude of → Taxation
→ Expenditure
→ Govt. tries to stablize the economy wrt → inflation / unemployment.

Stabilisation
collection
allocation
} → Macroeconomic objectives.

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Budgeting Techniques

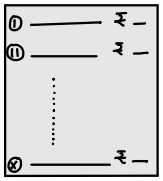
Methods of preparation of budget → accounts for the future.

↓

How you present this plan is budgeting technique.

① Line - item budgeting

Simplest and oldest, commonest.



line by line & item by item → areas of expenditure & money written

ex: Cab ride taken to go for a movie.

↓

entertainment OR transport expense.

Issues:

① Excessively detailed exercise

⑪ Too much data v. too less information

↓

When this data is organised in various sub-headings

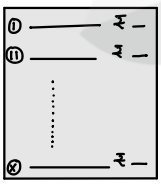
↓

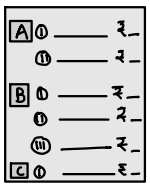
'programs'

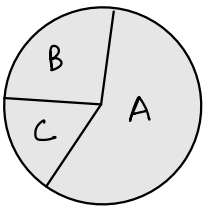
↓

⑪ Program Budgeting

Raw data → segregated under different programs → presented in a visually appealing format







This is the first stage of government budgeting.

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(iii) Performance Budgeting

Analyse the budget → Prepare the Budget → Ensure that it is efficient → since this is hard earned money of citizens.

Here, Performance of expenses is assessed at the end of year

Budget → NOT merely AFS. → macroeconomic objectives

Eg. Sarva Siksha Abhiyan → 100 schools, ₹ 1000 crore → Only 20 schools built → efficient expenditure NOT done.

We will calculate

$$\eta = \frac{\text{Output}}{\text{Input}} = \frac{20}{1000}$$

Efficiency is taken into account while preparing next budget.

→ Maximum output for minimum input.

(iv) Outcome Budgeting

focus on the Outcome

Performance budgeting	Outcome Budgeting
focus on o/p as a proportⁿ of i/p	End result

Number of hospitals built → % of MMR reduced

Number of schools built → Improvement in learning outcomes. → if due to lack of toilets girl children do not go to schools.

→ outcomes NOT met.

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(V) Zero-based budgeting → to ensure outcome budgets.

Traditional Budgeting → Previous Budget (Base) → adjustment → Adding / Substracting

ZBB → assumes no budget is automatically approved

every expenditure is analysed from zero base every year.

↓

Each department's budget is re-evaluated from the scratch. (or zero base)

↓

Justification of Expenses necessary

↓

Performance and Outcome assess, before allocatn.

(VI) Gender Budgeting → NOT merely allocation to women.

↳ type of budgeting where differential impact of an expenditure is assessed.

It is a form of analysis

↓

assesses the differential impact on women

How it is done?

Gender Budgeting Cell (MoWCD)

↓

analyzes allocation of Budget for its differential impact.

Thus, it is a gender incorporative analysis of budgetary allocation.
ex: impact of law and order spending on women.

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Accounting in Government Budgeting

① Estimates in a budget

Article 112 in Constitution of India

112. Annual financial statement

(1) The President shall in respect of every financial year cause to be laid before both the Houses of Parliament a statement of the estimated receipts and expenditure of the Government of India for that year, in this Part referred to as the "annual financial statement".

Budget Presentⁿ ⟶ 1st Feb, 2025

↓

Budget ⟶ presented ⟶ 2025-26 : Budget Estimates

For 2024-25 ⟶ Financial year ⟶ not ended

But, we have better estimates for remaining two months

↓

Revised estimates for 2023-24 will be presented.

For 2023-24 ⟶ the accounting for this year will be completed

↓

The actual figures will be presented

↓

Actuals

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		2022-2023 वास्तविक Actuals	2023-2024 बजट अनुमान Budget Estimates	2023-2024 संशोधित अनुमान Revised Estimates	2023-2024 संशोधित अनुमान[1] Provisional Actuals[1]	2024-2025 बजट अनुमान Budget Estimates
1. ऋण प्राप्तियां (निवल)	1. Debt Receipts (Net)	1739378	1798604	1761424	1825842	1472915
2. बाजार उधार (सरकारी प्रतिभूति)	2. Market Borrowings (G-sec)	1105836	1180911	1180456	1177754	1163182
3. अल्पावधि उधार (टी-बिल आदि)	3. Short term Borrowing (T-Bills etc.)	112009	50000	1323	53205	-50000
4. अल्प बचतों की तुलना में प्रतिभूतियां	4. Securities against Small Savings	395860	471317	471317	451399	420063
5. राज्य भविष्य निधियां	5. State Provident Funds	5089	20000	5200	5070	5000
6. अन्य प्राप्तियां (आंतरिक ऋण निधि और लोक लेखा)	6. Other Receipts (Internal Debts and Public Account)	83460	54258	78296	83293	(-)81282
7. विदेशी ऋण	7. External Debt	37124	22118	24832	55121	15952
8. नकद शेष में आहरण द्वारा कमी	8. Draw Down of Cash Balance	(-)1622	(-)11787	(-)26652	(-)172172	140397
कुल जोड़ (राजकोषीय घाटा)	Grand Total (Fiscal Deficit)	1737755	1786816	1734773	1653670	1613312

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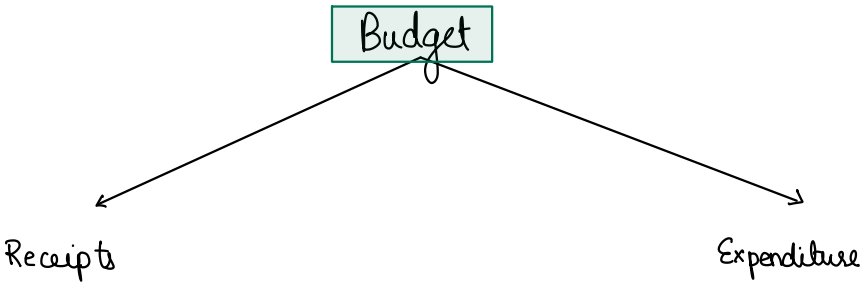
Components of Annual Financial Statement



Art 112(2)

(2) The estimates of expenditure embodied in the annual financial statement shall show separately--

(a) the sums required to meet expenditure described by this Constitution as expenditure charged upon the Consolidated Fund of India; and

(b) the sums required to meet other expenditure proposed to be made from the Consolidated Fund of India,

and shall distinguish expenditure on revenue account from other expenditure.

→ The word capital is NOT mentioned here.

→ Two things have developed out of convention.

① In place of 'others' → capital is mentioned.

① We also distinguish reciept along with expenditure

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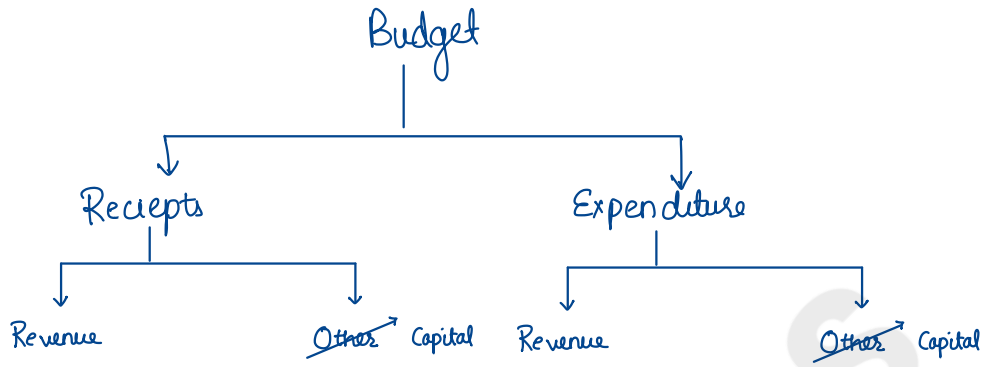
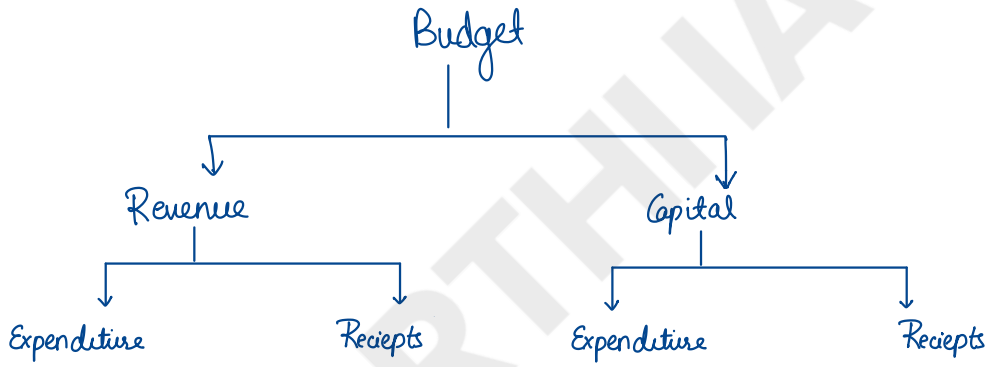
Two ways to present budget

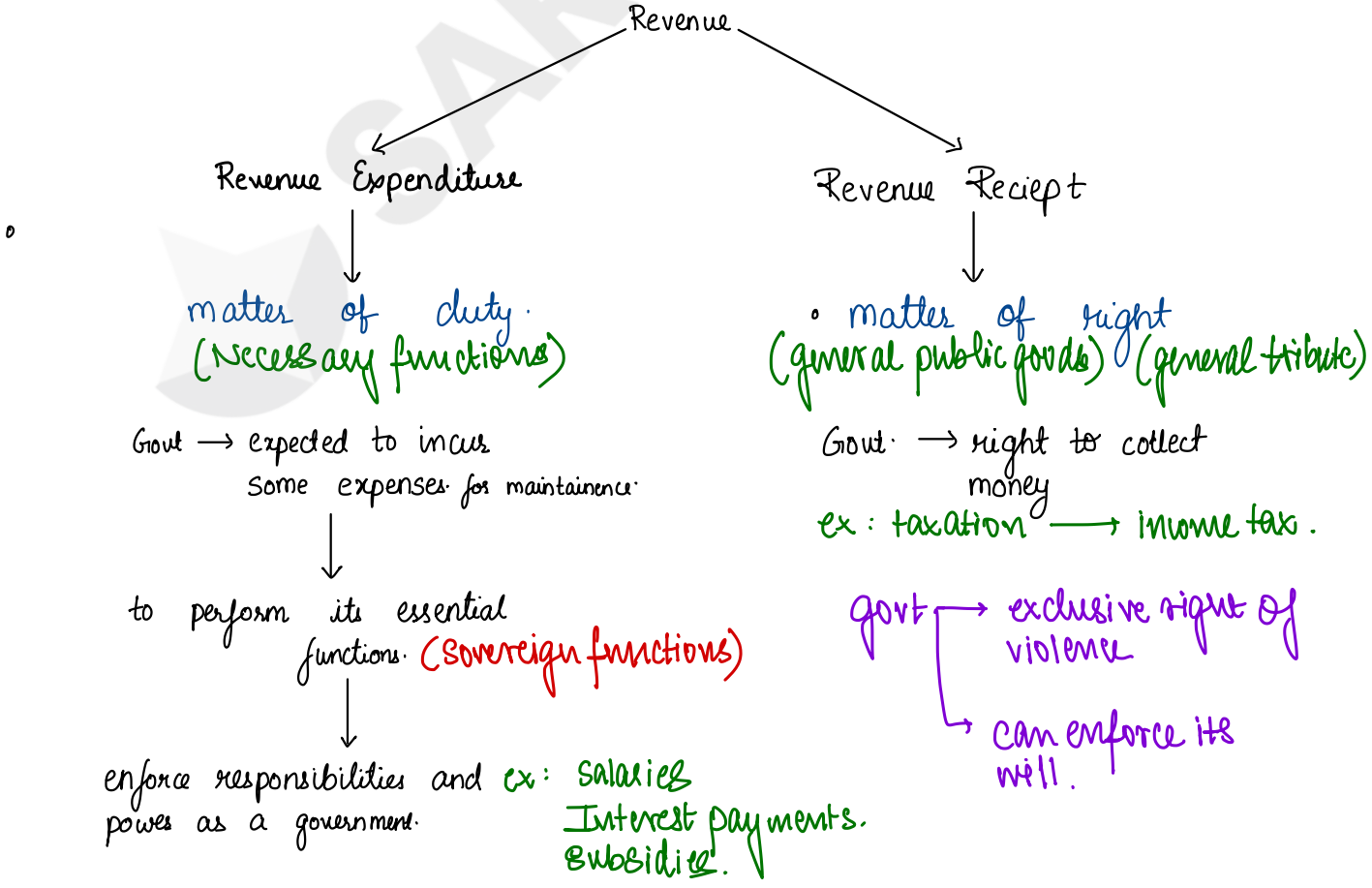
①



②



★ This is normally followed.



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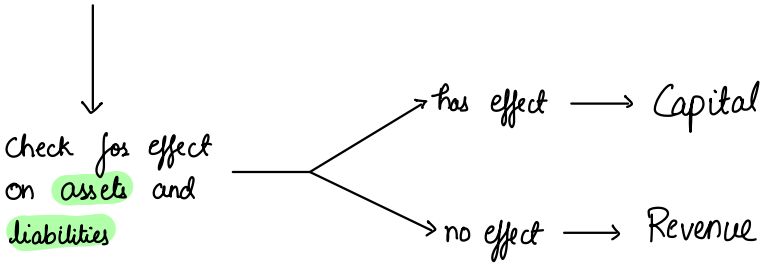
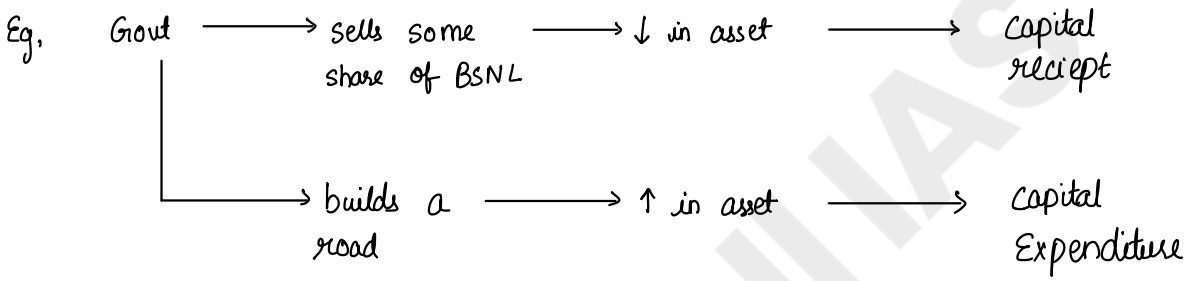
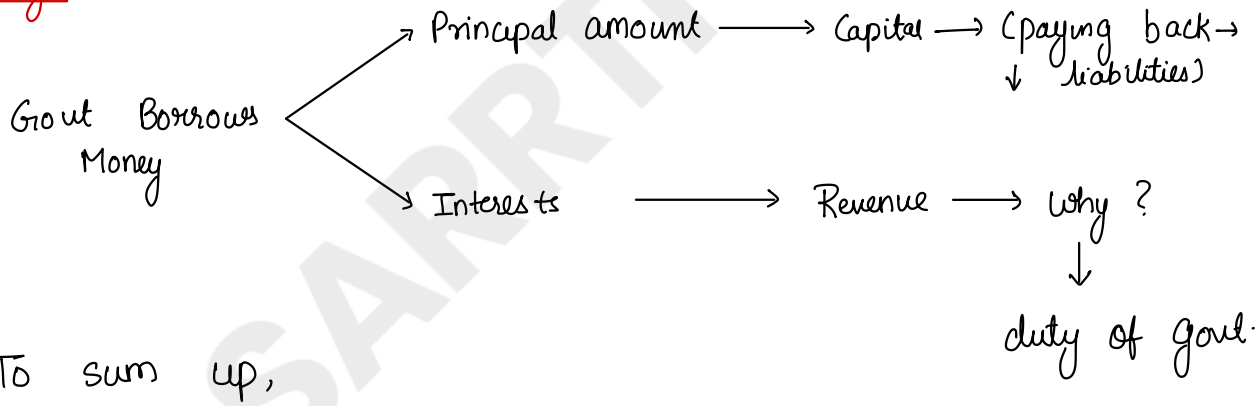
Capital Account



Asset



Liability



To sum up,

		Assets	Liabilities
Capital	Receipts	−	+
Capital	Expenditure	+	−

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Think?

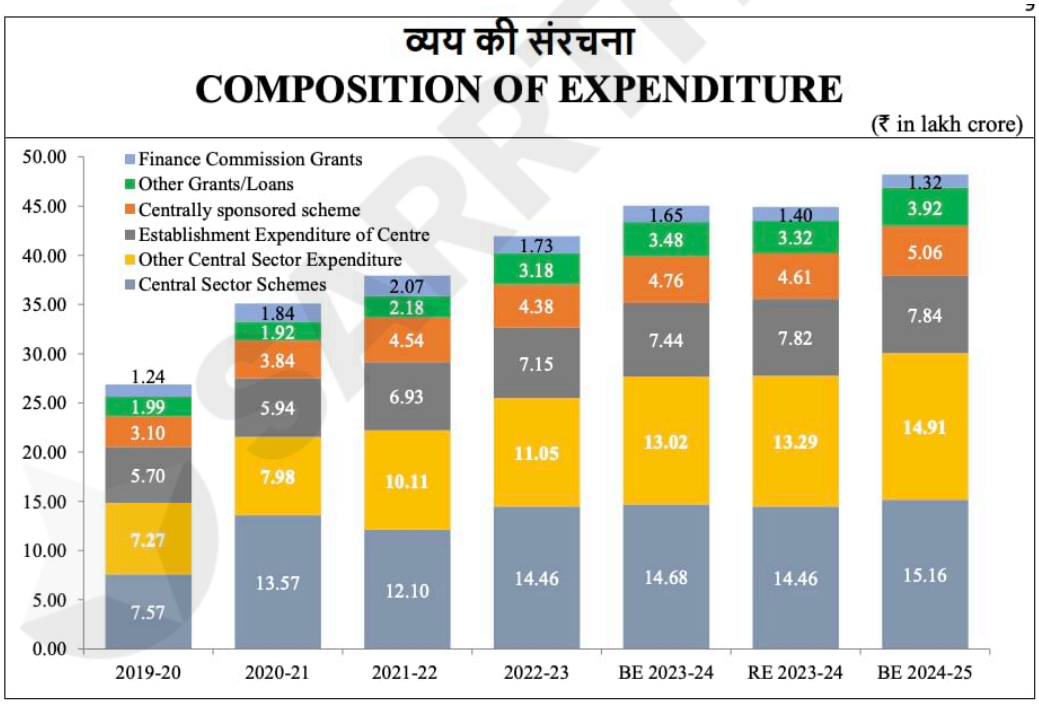
Payment → Salary → Right or Duty? → Capital or Revenue Expenditure ?

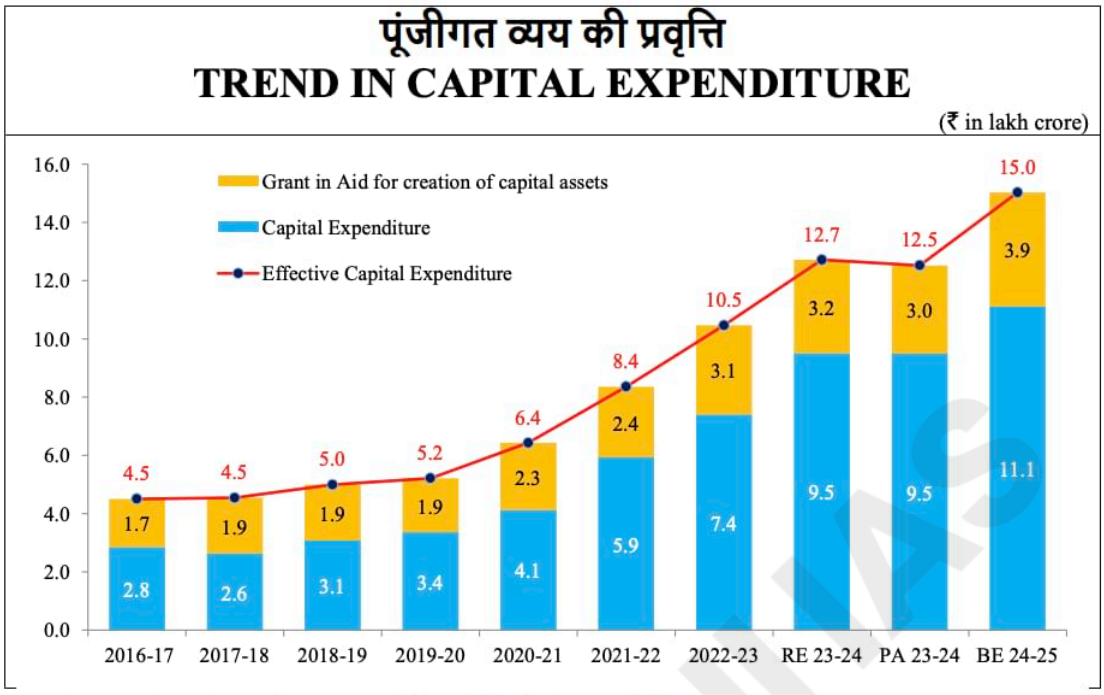
Now,

Lending Money → Principal → Asset → Capital Expenditure

Lending Money → Interest → No impact on Assets / Liabilities → Revenue Receipts

Grant → no expect^{n} of getting money back → no impact on asset of liability → Revenue Expenditure





Revenue Receipts → Tax → Income tax | GST | corporate tax etc.

Revenue Receipts → Non tax → Interest received by govt

Non tax → dividend/profit

Non tax → Grants from foreign govt.

Capital expenditure → creation of financial assets, physical assets, reduction of liabilities.

Capital Receipts → Debt → Borrowing by govt ↑

(assets -)
(Liability ↑)

Capital Receipts → Non debt → Selling of shares in PSUs.

Non debt → Loan Principal amount repayment.

Selling of shares in PSUs. → partial
Selling of shares in PSUs. → Strategic disinvestment (govt → Minority shareholder).
Selling of shares in PSUs. → Full disinvestment.

Grants ⟶ in Revenue account
↓
No impact on asset and liabilities.

Govt lends money ⟶ capital expense
↙ ↘
Interest → Revenue Receipt
Principal → capital receipt.

Govt sells shares of SBI ⟶ asset ↓ ⟶ capital receipts

Govt receipts dividend from SBI ⟶ No impact of assets and liabilities.
↓
Revenue Receipts.

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Government Budget

- Revenue Budget
  - Revenue Receipts
    - Tax Revenue
    - Non-Tax Revenue
  - Revenue Expenditure
- Capital Budget
  - Capital Receipts
    - Debt Capital Reciepts
    - Non-Debt Capital Reciepts
  - Capital Expenditure

Tax Revenue → Finance commission recommends
- vertical devolution of Net tax proceeds
- Horizontal devolution of tax proceeds.
- article 275 → Grants in aid. (Revenue filling grants from remaining center's shares).

Schemes of the Central Government

① Centerally Sponsored Schemes
② Central Sector Scheme

} Money left over after basic functions performed.

Why these schemes?

① States → entrusted with more responsibility

② Centre → after performing its core functions → left with money → This money is spent to formulate schemes

- Central Sector Schemes
  - Primarily related to Union list
  - eg Bharat net → Union list → Entry 31: Telephones, wireless, broadcasting
- Centrally Sponsored Scheme
  - Sponsoring schemes in state list.
  - Eg, PM-Krishi Sinchai Yojana → State list — Entry 14 → Agriculture

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Earlier

Planning Commission (1950s) → Five Year Plans → created two types of schemes

- Common schemes for all states on State subjects. ← PC will ask states to accept as own.
- Competence of States → Centrally Sponsored Schemes. (Challenge to federalism)
- Competence of Centre → Central Sector Schemes

As a result → PC became a very powerful body.

States approached (PC) to formulate common schemes for their state's need. → top down spending. [conflict b/w State + Centre schemes]

Over a period of time → number of schemes → 150

2013 → restructuring of schemes → number → 66

2015 – Centre set up a → 'Sub-Group of CMs on Rationalisation of Centrally Sponsored Schemes' [Shivraj Singh Chouhan].

↳ Suggestions: → Rationalisation of Schemes
→ Flexibility of States wrt implementation of Schemes.
→ Division of CSS → Core Schemes / Optional Schemes

Out of Core → Those focused on 'Social Protect^{n} & Social Inclusion

8 ← Core of Core Schemes

Funding pattern:

From now onwards, the sharing pattern should be:
For Core Schemes
a) *For 8 NE and 3 Himalayan States: Centre: State: 90:10*
b) *For other States: Centre: State: 60:40*
c) *For Union Territories: Centre: 100%*

For Optional Schemes
a) *For 8 NE and 3 Himalayan States: Centre: State: 80:20*
b) *For other States: Centre: State: 50:50*
c) *For Union Territories: Centre: 100%*

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Special category states → center's share comes as grant and NOT a loan.

→ other states → loan

Now this tag NOT there.

Capital expenditure

→ creates assets, reduces liabilities.

↓

very low amount of money left

↓

But very important for infrastructure.

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Deficits

It is a situation of deficiency, where inflow is not adequate as compared to outflow.

Total Expenditure = Revenue Expenditure + Capital Expenditure

Total Revenue = Revenue Reciepts + Capital Reciepts

= Revenue Reciepts + Non-Debt Capital Reciepts + Debt Capital Reciepts

Budget Deficit = Total Expenditure − Total Revenue

Monetised Deficit — part of Budget deficit which is monetized by RBI by printing currency.

- If Budget Deficit = 0 ⟶ Balanced Budget
- If Budget Deficit > 0 ⟶ Budget in Deficit

Before 1997 ⟶ Govt. presented "Budget in Deficit"

Why? — Budget as a tool of politics

Monetizn of deficit ⟶ Compromise of RBI's independence
- ⟶ Poor Quality of procured assets
- ⟶ Compromise of Monetary Policy.

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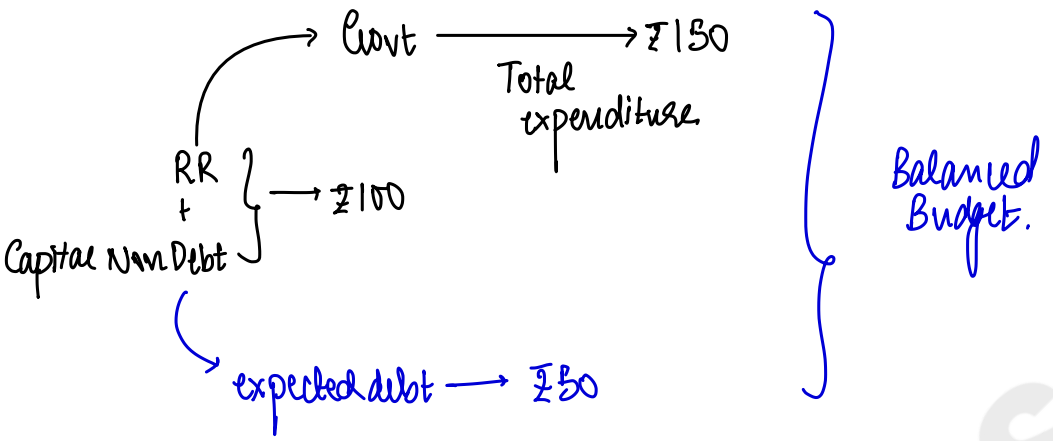

Budget in deficit → Before 1997

- TE → ₹ 200
- TR → ₹ 150 (including debt)

Why? POLITICAL tool.

Logic: parliamentary approval

- fulfilling was NOT possible.
- only announcement NOT implementation.

1972 → CADP

1995 → Backlog of 1500 canals → AIBP → No new announcement complete previous

2016 → PM Krishi Sinchai Yojana → 1 component is AIBP.

due to Budget fake → govt loss of accountability. [Lack of trust in fiscal policy]

Govt must get → theoretically from somewhere.

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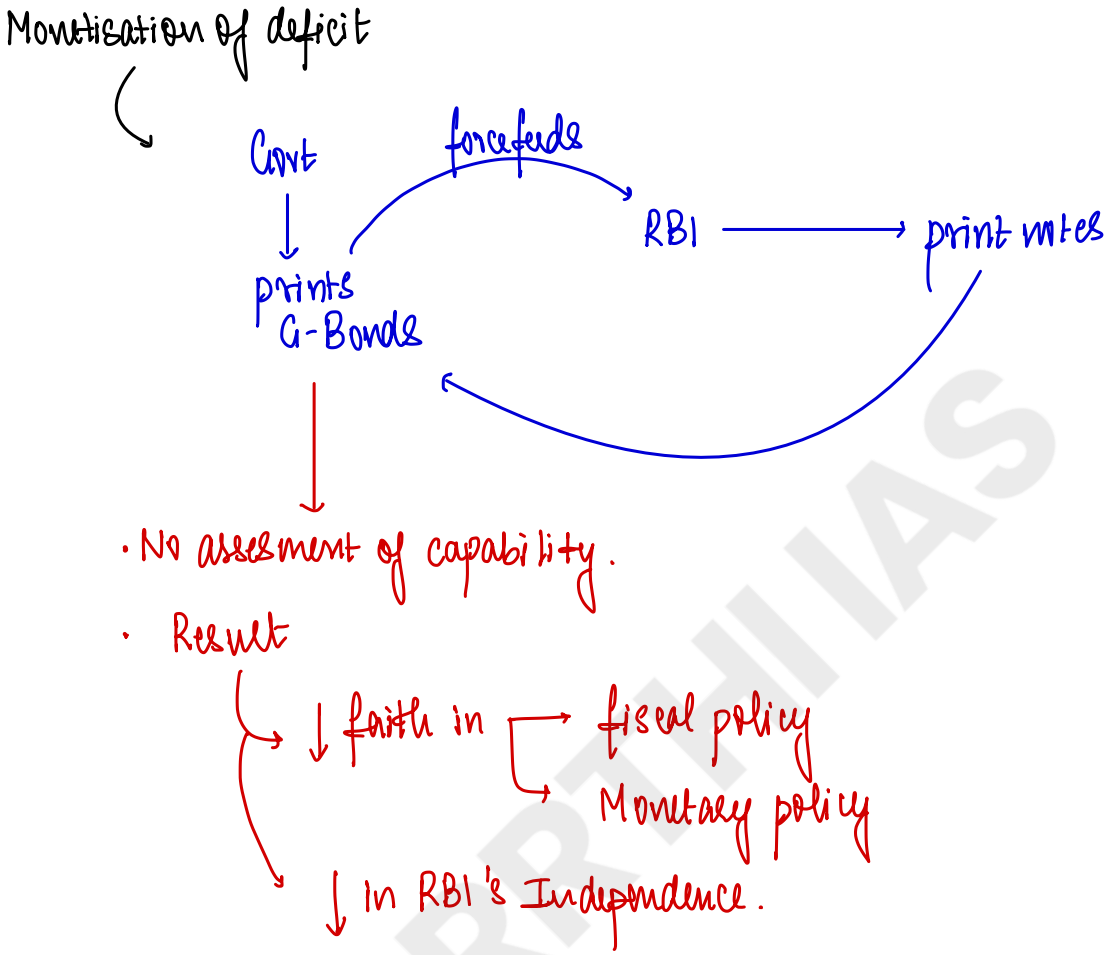
Monetisation of deficit
Govt
forcefeeds
RBI
print notes
prints
G-Bonds
• No assesment of capability.
• Result
↓ faith in
fiscal policy
Monetary policy
↓ in RBI's Independence.

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In 1997 ⟶ Govt + RBI

↓

Ways and Means Advances Agreement

Govt ⟶ no longer Budget in Deficit & Monetised Budget

RBI ⟶ It will lend money under some special circumstances.

↓

- Short-term liquidity mismatch
- No long-term borrowings

WMA
- w/o interest & security ⟶ some part
- with security and interest ⟶ remaining part
  - Special WMA ⟶ lower rate of interest (Repo − 1%)
  - Normal WMA ⟶ after Special WMA is exhausted
    ↓
    Interest Rate = Repo Rate
- some overdraft allowed.

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RBI raises WMA limits of States/UTs by 28% to ₹60,118 crore

Based on the recommendations made by the Group constituted by the Reserve Bank and consisting of select state Finance Secretaries and taking into account the expenditure data of the states for the recent years, it has been decided to revise the WMA limits of the State Governments/ UTs, effective from July 1, 2024, the RBI said in a circular

FRBM Act, 2003

↓

Logical consequence of Agreement on Ways and Means Advance.

↓

Introduced : 2000 ⟶ passed : 2003

Why? ⟶ to impose discipline in Government Borrowing.
- Now govt must borrow from the Market.
- Market determined price and yield.
- govt Borrows @ Market price.

Objective:

Initial FRBM Targets (to be met by 2008-09)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2009. The minimum annual reduction target was 0.5% of GDP.
2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2009. The minimum annual reduction target was 0.3% of GDP.
3. Contingent Liabilities – The Central Government shall not give incremental guarantees aggregating an amount exceeding 0.5 per cent of GDP in any financial year beginning 2004-05.
4. Additional Liabilities – Additional liabilities (including external debt at current exchange rate) should be reduced to 9% of the GDP by 2004-05. The minimum annual reduction target in each subsequent year to be 1% of GDP.
5. RBI purchase of government bonds – to cease from 1 April 2006. This indicates the government not to borrow directly from the RBI.

Targets and enforcement
- FD ⟶ <3% of GDP
- RD ⟶ 0% of GDP.

Multiple accompanying statements.

Fiscal Deficit ⟶ total Borrowings of the govt.

Total Expenditure = Revenue Receipts (RR) + Debt Capital Receipts (DCR) + Non-Debt Capital Receipts (NDCR)

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Fiscal policy statements to be laid before Parliament.—

(1) The Central Government shall lay in each financial year before both Houses of Parliament the following statements of fiscal policy along with the annual financial statement and [7][demands for grants except the Medium-term Expenditure Framework Statement], namely:—

(a) the Medium-term Fiscal Policy Statement;

(b) the Fiscal Policy Strategy Statement;

(c) the Macro-economic Framework Statement;

[8][(d) the Medium-term Expenditure Framework Statement.] → inserted 2012

FISCAL consolidation roadmap.

Total Exp = Total Revenue

CE + RE = RR + Debt capital Receipts + NDCR

fiscal deficit. → total borrowing of the govt

this is gross fiscal deficit

Now we will refine this

Debt CR = TE - (RR + NDCR)

RE

CE → govt loans given out (principal)

Gross FD - govt lending = Net FD

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$\Rightarrow$ DCR = Total Expenditure $-(RR + NDCR)$

↓

This is called Gross Fiscal Deficit.

Net Fiscal Deficit = Gross FD − lending by Government.

Primary Deficit

Fiscal Deficit = Total Expenditure − Non-Debt Receipts

- Revenue Expenditure
  - Interest Payments
    - remove this to get → Primary Deficit
  - Other Revenue Expenditure
- Capital Expenditure

this is being done on previous loans.

Primary Deficit = Fiscal Deficit − Interest Payments

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Revenue Deficit = Revenue Expenditure − Revenue Receipts

Need?
↳ to understand the money spent in performance of sovreign functions of govt. → does govt Have enough to maintain its sovereign functions.

Progress of government in meeting FRBM Targets

↓

By 2007-08 → Fiscal Deficit → 2.7% of GDP
↳ Revenue Deficit → 1.1% of GDP

In 2008 → 2009 → elections
↳ Global Financial Crisis
↓
need to spend
↓
Launch of Big Schemes
eg, MGNREGA
↓
Ballooning of Fiscal Deficit

Amendment → 2008 —shift in target→ 2010

Again → Amendments in FRBM Act
↙ ↘
2012 2015
Introduction of Effective Revenue Deficit

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Effective Revenue Deficit

Logic :

Revenue Expenditure → Major portion

Transfers to States can be used

- Revenue Expenditure
- Capital Expenditure

Eg. MGNREGS

- Payment of Salary
- Construct^{n} of Assets

Both comes under Revenue expenditure

Construct^{n} of Assets

- By def^{n} : Revenue Expenditure
- By use : Capital Expenditure

We remove → 'Transfers to states for creation of Capital Assets'

from Revenue Deficit

ERD = Revenue Deficit − 'Transfers to for creation of Capital Assets'

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FRBM Targets after Amendment to FRBM Act in 2012 (to be achieved by 2015)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2015. The minimum annual reduction target was 0.5% of GDP.
2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2015. The minimum annual reduction target was 0.3% of GDP.

FRBM Targets after Amendment to FRBM Act in 2015 (to be achieved by 2018)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2018. The minimum annual reduction target was 0.5% of GDP.
2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2018. The minimum annual reduction target was 0.3% of GDP.

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NK Singh Committee

↓

Set up by the govt. ⟶ to review FRBM Act, 2003

Recommendations:

① Difference b/w Debt and Deficit

Debt ⟶ accumulated borrowings ⟶ a stock variable

Deficit ⟶ difference for the year ⟶ a flow variable

FRBM Act, 2003 ⟶ targets for Deficits, not for debt

The Committee recommended ⟶ Targets should be wrt Debt

↓

Within this, we should have Fiscal Deficit targets

Targets for Debt ⟶ 60% of GDP
- ⟶ Centre ⟶ 40%.
- ⟶ States ⟶ 20%.

Fiscal Deficit ⟶ 3%.

⑪ Counter-Cyclical Expenditure Policy

Logic: to give flexibility to government to spend more in certain times

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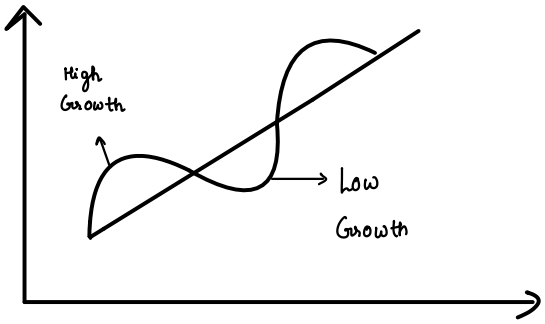

Economy goes through Cycles

High Growth

- Revenue of govt ⟶ High
- Employment ⟶ High

↓

need to spend is low.

↓

control expenses

↓

Borrow less

Low Growth

- Revenue ⟶ low
- Employment ⟶ High

↓

need to spend is High

↓

increase expenditure

↓

Borrow more

Conditions :

① War
② Natural Calamity
③ Severe Agricultural Collapse
④ Structural reforms
⑤ Significant economic downturn

Deviation allowed ⟶ 0.5% from the target of Fiscal Deficit.

Other Recommendations :

① Repeal FRBM, 2003 ⟶ Bring Debt and Fiscal Responsibility Act

② Set up ⟶ Fiscal Council ⟶ Chairperson + 2 members

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FRBM Act (Amendment), 2018

- General govt. Debt ⟶ 60%
- Central govt. Debt ⟶ 40%

- Revenue Deficit Target ⟶ 3% of GDP (Mar 31, 2021)

- Escape Clause ⟶ 0.5 % ⟶ for unforeseen circumstances.

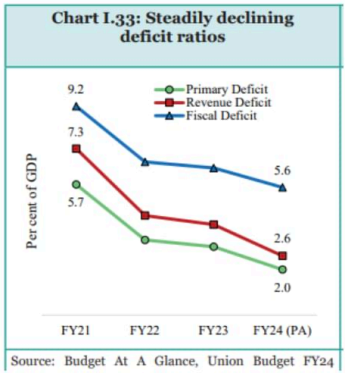
2020 ⟶ Escape Clause by Finance Ministes
↓
Fiscal Deficit Targets revised

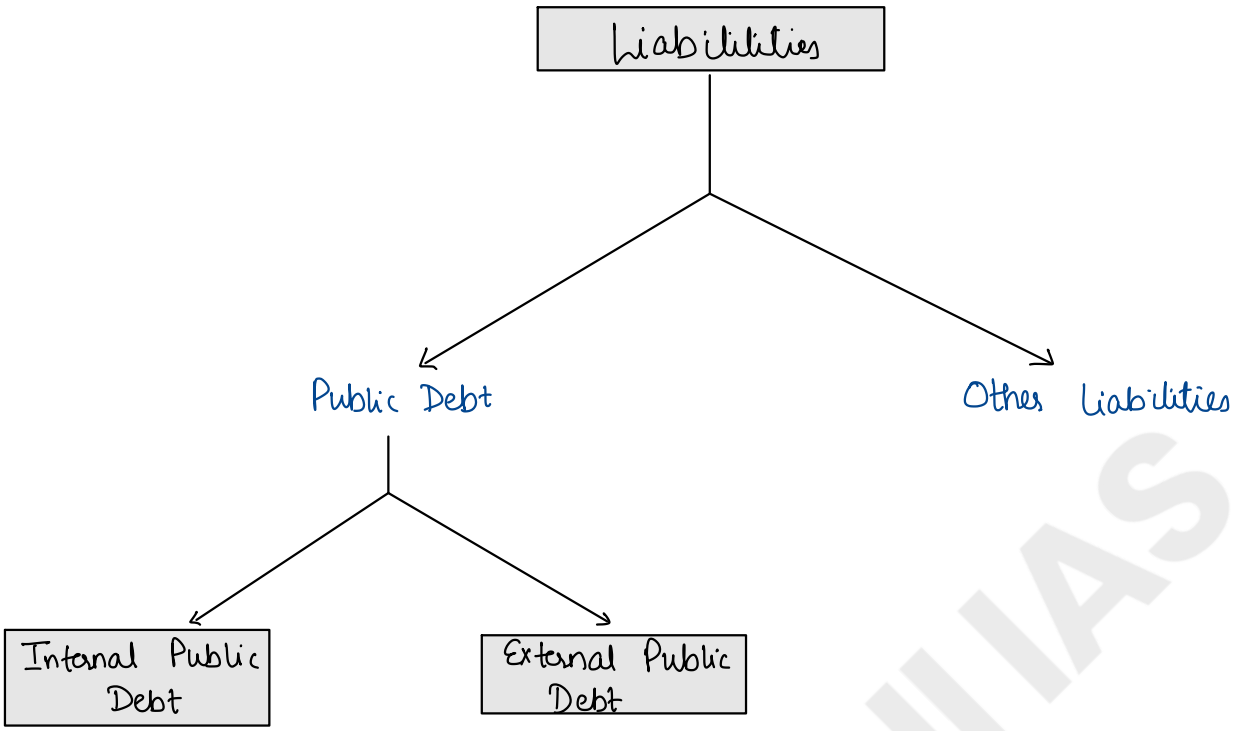
2021 ⟶ FRBM Act
↳ Amended ⟶ target ⟶ 4.5%

COVID-19
↳ Debt to GDP Ratio ⟶ 90% ⟶ Union Govt ⟶ 58.7%
↳ States ⟶ 31%

FY 21 ⟶ Fiscal Deficit ⟶ 9.2% of GDP

Present scenario ⟶





① Public Debt
↳ debt owed by the government

Two Components :

① Internal Public Debt

- Debt owed by the govt. to residents
- Eg. G-Secs, T-Bills, Loans from Other Financial Institutions (Banks, FIIs)

⑪ External Public Debt ⟶ not external debt

- Debt owed by the govt. to non-residents

↓

issued in foreign market ⟶ Foreigners, NRI, World Bank, IMF

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Components :

G- Secs ⟶ Secured debt instruments

↳ security against Consolidate fund of India

T- bills ⟶ unsecured borrowing

↓

issued for very short term

- Issued at a discount and redeemed at par values
- Only issued by the Central govt ⟶ can't be issued by State

T- Bills ⟶ issued at discount

Face Value ⟶ ₹ 100

Issued price ⟶ ₹ 98 (@ discount)

They are Zero - Coupon debt instrument.

Sovereign Debt Bonds

↳ when govt. issues bonds in foreign market, these bond are called Sovreign Debt Bonds

Govt can issue these bonds in foreign Countries.

↓

doesn't necessarily need to be denominated in foreign currency.

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Masala Bond → rupee denominated off-shore debt instrument

External Commercial Borrowings
↓
Any entility borrowing from Outside India

Reliance Industries → Foreign Markets → Domestic Currency
Foreign Currency
Domestic Markets

External Debt → for all entities

FII / Foreign Institutional Investors
↓
purchases govt. bonds → issued in Indian Markets
↓
in Indian Rupees
↓
Rupee-denominated debt → FII ⇄ Exchange Market ($ / ₹)
invest
↓
Bonds / Equity

Where will be this debt counted?
Internal
External

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Other Liabilities of govt. ⟶ different from Debt

Debt

- voluntary
- Borrowed funds → to be repaid.
- Eg. Bank loans, Corporate Bonds

Liabilities

- Voluntary / Involuntary
- all financial obligations / amount owed by an individuals
- Eg, Accounts payable, wages payables and debt.

Note: All debts are liabilities, but not all liabilities are debt

Public Debt

- money that government has borrowed.

Other liabilities

- includes money of someone else that Government holds → Govt is a custodian here. → paybacks with interest.

Eg, Public Provident Funds,
Kisan Vikas Patra,
National Savings Certificate

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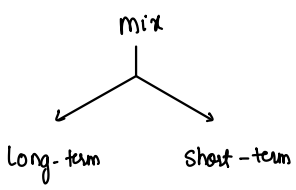
Principles of Debt Management

To ensure → Debt → Sustainable
Bearable
doesn't cause inter-generational equity

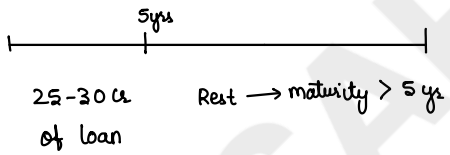
Principles to be followed:

① Borrowing at minimum Cost
↓
Debt Sustainability

② Looking at Maturity Profile
↓
mix



Eg, If Debt = 100 cr



③ Preferably financed locally → Internal Debt

④ Denominated in domestic currency

Why? — ① We need foreign currency to repay foreign imports.
↓
need to have forex revenue to cover six months of imports.

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Ⓥ Ability to check interest rate - Growth Differential

Does Growth Lead to Debt Sustainability? Yes, But Not Vice-Versa!

02 CHAPTER

Concept of IGRD (Interest Growth Rate Differential)

$IGRD = r - g$

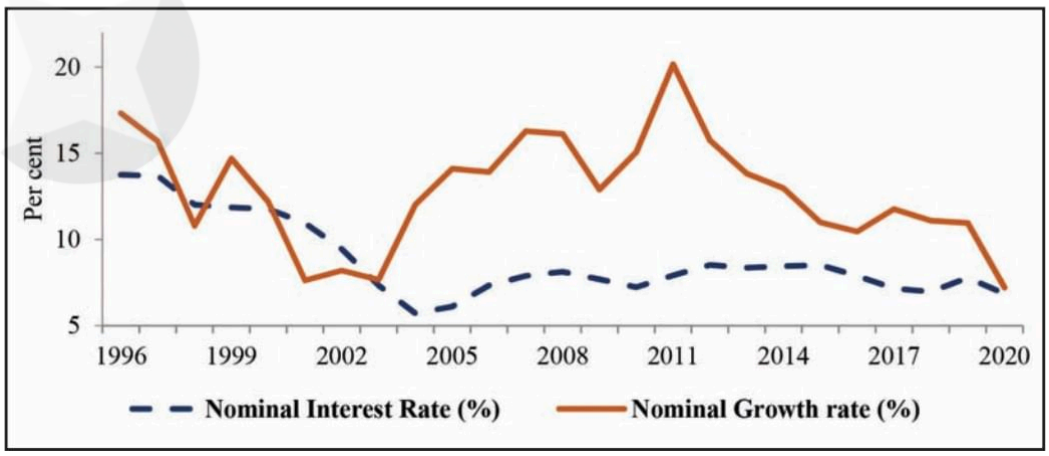
r ⟶ nominal rate interest

g ⟶ Growth rate

If $(r-g)$ ⟶ -ve ⟶ Debt Sustainable

If $(r-g)$ ⟶ +ve ⟶ Debt Unsustainable

2a: During the Last 25 years, i > γ is a Norm, Except for a Short Period During the Asian Financial Crisis



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Taxation

Tax is a general payment that public makes to the govt.

Why? ⟶ for provision of public goods.

Types ⟶ based on bearer of burden

- Direct Tax ↓ Tax payer bears the burden
- Indirect Tax ↓ Taxpayer doesn't bears the burden of tax

Govt ⇄ (levy / pays) A

Govt ⇄ (levy / pays) A ← (pays) B

Eg, Income Tax, Real Property Tax

Eg, Excise duty, GST

Distributive Function ↓

① Progressive Taxat^n ⟶ ↑ income ⟶ More tax

② Regressive Tax^n ⟶ ↑ income ⟶ less tax

③ Proportional Tax^n ⟶ If tax ∝ Income

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① Ad valorem Tax

↓

Tax levied according to the value.

② Specific Tax

↓

Tax levied according to specific character apart from value.

↓

weight / colour etc

Eg,

		Price (w/o Tax)	Tax (as per value) (20%)	Tax according to length	Total Cost
Cigarettes →	Longer one →	₹ 15	₹ 3	30% → ₹ 4.5	₹ 22.5
	Shorter one →	₹ 10	₹ 2	20% → ₹ 2	₹ 14

Length of Cars → <4 m ; >4 m → different tax

GST rates on cars in India

Type of vehicle	GST rate	Additional cess	Total tax rate
SUVs (length > 4m, ground clearance > 170mm)	28%	22%	50%
Luxury cars (length > 4m, >1500cc)	28%	20%	48%
Mid-sized cars (petrol/diesel, > 4m)	28%	15%	43%

Fuel → More tax → Diesel → more polluting

↳ Less tax → Petrol

↳ EVs

Small cars (diesel, <1500cc, length < 4m)	28%	3%	31%
Small cars (petrol, <1200cc, length < 4m)	28%	1%	29%
Electric vehicles	5%	0%	5%

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Cess ⟶ not a specific tax

↓

tax which has specific purpose

↓

imposed as an additional tax besides the existing tax.

↓

Central Govt ⟶ doesn't need to share it with states

Various types of cesses levied by the government

The government levies different cesses on services it provides to the public. Some of them are as follows:

Education cess: Collected by the government to provide the mandatory free standard primary education to all citizens.

Health cess: Proposed in 2018 by former finance minister Arun Jaitley to meet the health requirements of below-poverty-line families.

Road cess or fuel cess: For maintenance of roads and infrastructure.

Clean energy cess: Introduced in 2010, it is a carbon tax on the production and import of coal, lignite and peat, operating on the "polluter pays" principle.

Krishi Kalyan cess: It was introduced in 2016 to provide additional support to farmers for agricultural activities.

Swachh Bharat cess: Introduced in 2014 with the objective of delivering a clean India, it is levied at 0.5 per cent on all taxable services to fund Swachh Bharat initiatives.

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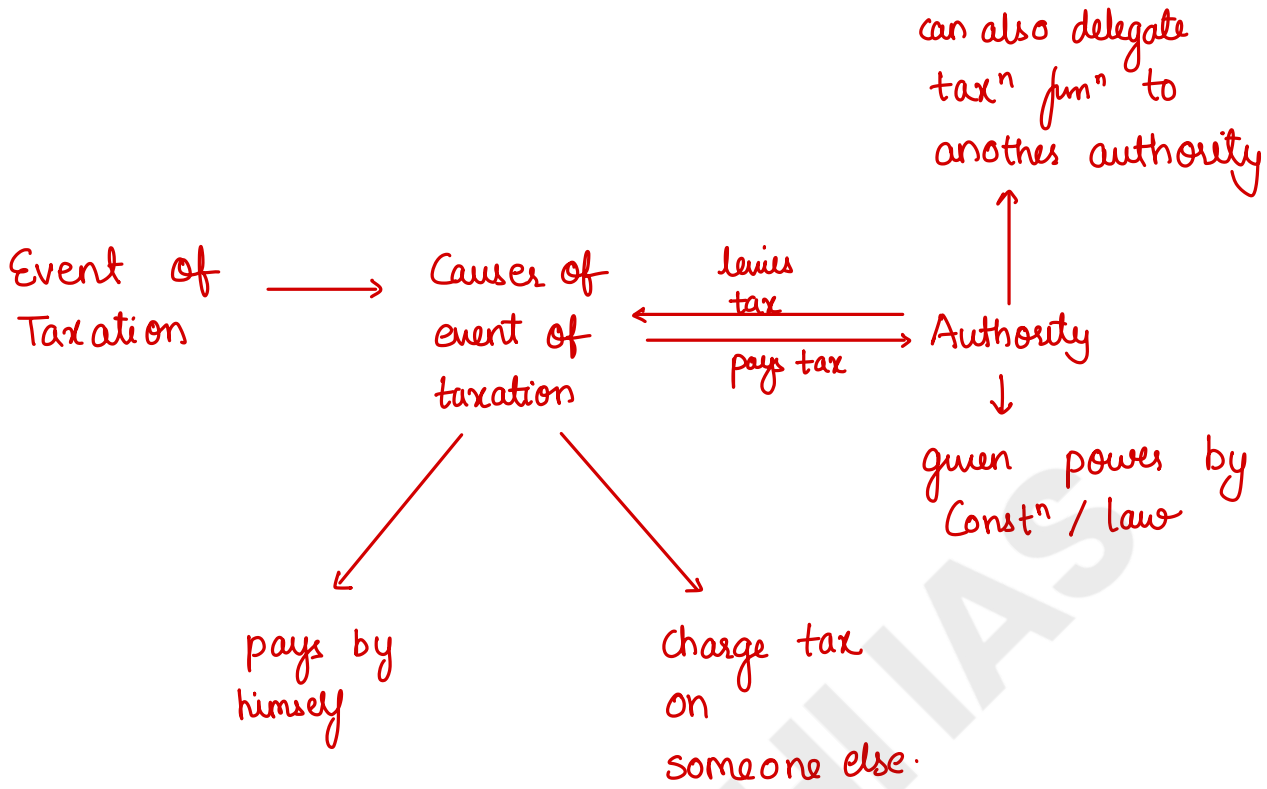

Tax Name	Event of Taxation	Levying Entity	Responsibility to Pay to the Government	Actual Bearer of the Burden
Income Tax	Earned income from any source	Centre	Earner	Earner
Corporate Income Tax	Profits of the company reported under IT Act	Centre	Company	Company
Minimum Alternate Tax	Only if Corporate Income Tax (CIT) < 18% of profits reported under Companies Act	Centre	Company	Company
Other Direct Tax Examples: Wealth Tax (Centre), Professional Tax (States), Capital Gains Tax (part of IT)				
Excise Duty	Production	Centre	Producer	Buyer
Customs Duty	Change of international boundary	Centre	Changer of boundary	Buyer
Sales/VAT/Service Tax	Sale of a good/service	States	Goods seller/service provider	Buyer
Central Sales Tax	Inter-state sale of goods	Centre (*Given entirely to states)		Buyer/Consumer
Entry Tax/Octroi, etc.	Entry into a state/district/municipality	States, district municipalities		Buyer/Consumer

Different types of taxes

① Income Tax

↳ direct tax levied by govt. on citizens.

↳ mandated by Income Tax Act, 1961

↳ includes ⟶ income from house property, profits from business, capital gains income.

Individual income ⟶ individual has to pay Income Tax

↓

Multiple exemptions under IT Act, 1961

↓

Reduct^{n} of tax burden

eg, Certain investment ⟶ Life Insurance, Health Insurance, PPF etc

Tax Slabs: Govt can change the slabs ⟶ Union Budget

Why ⟶ Govt encourages investment in certain areas.

Annual Taxable Income Slabs	New Tax Regime Slab Rates FY 24-25 (AY 25-26)
Up to ₹3,00,000	Nil
From ₹3,00,001 to ₹6,00,000	5% on income exceeding ₹3,00,000
From ₹6,00,001 to ₹7,00,000	5% on income exceeding ₹3,00,000
From ₹7,00,001 to ₹9,00,000	20,000 + 10% on income exceeding ₹7,00,000
From ₹9,00,001 to ₹10,00,000	20,000 + 10% on income exceeding ₹7,00,000
From ₹10,00,001 to ₹12,00,000	50,000 + 15% on income exceeding ₹10,00,000
From ₹12,00,001 to ₹15,00,000	80,000 + 20% on income exceeding ₹12,00,000
Above ₹15,00,000	140,000 + 30% on income exceeding ₹15,00,000

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(i) Corporation tax

- imposed on net income of the company.
- Both public and private companies ⟶ registered under Companies Act, 1956
  ↓
  liable to pay the tax

Sections	Tax rate	Surcharge
Section 115BA (Companies having turnover up to Rs 400 crore in FY 2017-18)	25%	7%/12%*
Section 115BAA	22%	10%
Section 115BAB	15%	10%
Any other case	30%	7%/12%*

(ii) Minimum Alternate Tax

↓

If a zero profit company

↓

15% MAT on 'Book Profits'.

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(N) Capital Gains Tax

↓

any profit recieved through sale of capital assets.

↓

falls in income category.

↓

can be → long-term → Long term Capital Gains Tax.

→ Short-term → Short-term Capital Gains Tax

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Indirect Taxes

① Excise Duty

↓

Event of tax^{n} ⟶ Product^{n}

↑

as soon as good comes to existence.

↓

Excise Duty is levied by Central Govt.

Working:

Samsung ⇄ (charges / pays excise duty) Distributor ⟶ Retailers ⟶ Consumes

Suppose a phone is produced ⟶ ₹10000 + 10% (Excise Duty) = ₹11000

② Custom Duty / Octroi Tax

↓

during change of administrative boundary

Who levies?

↓

Entity whose boundary goods are entering.

Domestic market:

State 1 ⟶ State 2 / District 2 ⟶ levies a tax

↓

Entry tax / Octroi Tax

Who will pay?

↓

person causing change in boundary.

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International market:

Country A (US) ⟶ Country B (India) ⟶ Central govt levies Custom Duty

(iii) Sales Tax

Sale ⟶ within the State
↓
State levies a Sales tax.

If inter-State Sale:

286. Restrictions as to imposition of tax on the sale or purchase of goods

Art 286

(1) No law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place.-

(a) outside the State; or

(b) in the course of the import of the goods into, or export of the goods out of, the territory of India.

Why? ⟶ It may lead to fragmentation of economy.

In this case, Centre levies a tax
↓
Central Sales Tax
↑
levied by Centre ⟶ given to the selling state entirely

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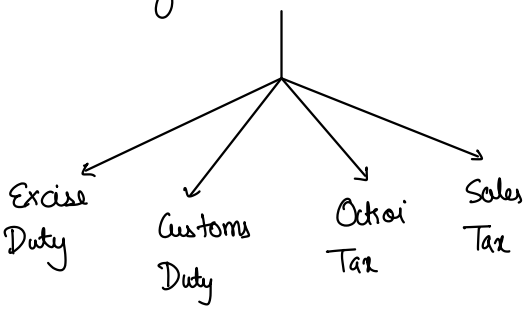
Before 2005: ⟶ Many Indirect Taxes



Change in method of taxation

Why?

Sales tax levied on value of Sales.

Price of Good = ₹ 1100

₹ 1000

10% Excise Duty

In event of Sale:

Tax on ₹ 1100 ⟶ Tax on Tax

Double Taxation

Cascading of tax

It was replaced with a value added Taxation System.

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Value Added Taxation System

↓

only value added at each stage is taxed

In 2000:

Opposition by States

↓

reduction in tax due to VAT System.

Proposed again in 2005:

Central govt ⟶ can't do anything

↓

Only make a model law.

↓

States were needed to change tax^{n} by themselves.

By 2010:

All States came to board

↓

Haryana was last to come.

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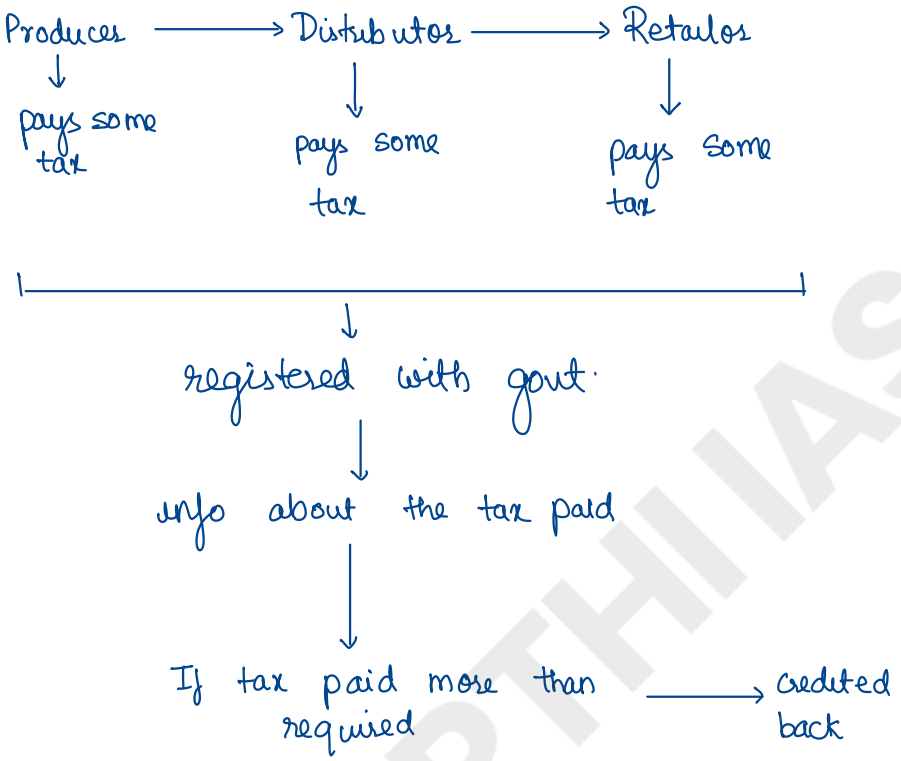
Input Tax Credit System



This system is the backbone of VATing System.

MODVAT and CENVAT

Central govt → started Excise Duty in form of VATing in 1980

Thus,

Sales Tax → Tax due & Tax Credit → maintained by Center

Excise Tax → Tax due & Tax Credit → maintained by States

multiple entities, departments and accounts → created issues.

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This lead to Goods and Services Tax

proposed first → 2009 → 2011 → 2015

2015 → 2017 → came to existence

Implication:

removed all other events of taxⁿ → Event of Sale → easy to offset.

Tagline of GST → One Nation, One Tax

- Reductⁿ of taxⁿ events → 1
- Taxation Authorities → 1 ← Here, States don't lose their power of taxⁿ

Center + States → pool their power → levy a common tax → distribute the proceeds

Better Taxⁿ System

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Anti - profiteering

Case I:

Production Cost	+	Profit	+	Tax	=	Price
₹30,000		₹2000		₹3000		₹35000

+ GST → 10%

₹3500

₹38500

Case II:

Production Cost	+	Profit	=	Price
₹30,000		₹2000		₹32000
		GST → 10% →		₹3200
				₹35200

Tax not the part of taxable amount

If a company → Issues invoices based on Case-I to the Consumer.
→ gives tax based on Case-II to the govt

This is called Anti-Profiteering. → Criminal Offence under GST regime

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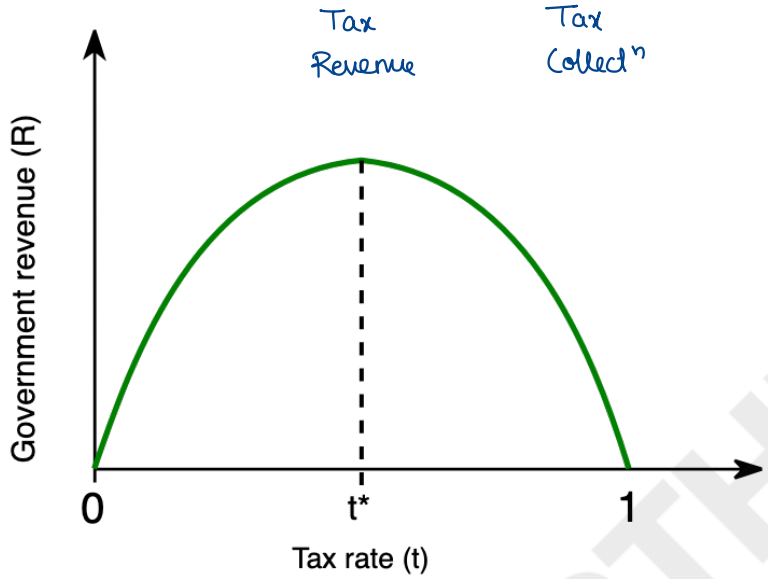
Laffer Curve

↳ inverted - U - shaped curve

↓

b/w

↙ Tax Revenue ↘ Tax Collectⁿ



At 0% Tax ⟶ Collected Tax ⟶ 0

At 100% Tax ⟶ Collected Tax ⟶ 0

⟶ At a point in between Tax collection ⟶ maxᵐ.

Tax Elasticity

It measures how tax revenue changes in response to tax rate

Formula : Tax Elasticity = $\frac{\Delta \text{ Revenue}}{\Delta \text{ Tax rate}}$ i.e. $\frac{\text{Change in taxes}}{\text{Change in tax}^{n} \text{ System}}$

It measures how tax collectⁿ changes when there is some change in tax administsation.

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GST → cost of compliance is reducing → tax forums ↓ Input credit ↑

→ cost of non compliance ↑

→ Systematic catching of people who do NOT comply.

Revenue Neutral Rate.

Arvind Subramaniam task force

→ to answer what should be the rate of GST taxation?

- Depends on increase in compliance
- Depends on Revenue Neutrality from previous system.

GST compensation cess.

2017 → GST implemented.

Before the implementation of GST → States collecting VAT.

Assume States revenue as per VAT

10,000
↓ 14%
14,400
↓ 14%
∴ for 5 years

In these numbers if there is a shortfall, center will compensate the State.

↓

Such compensation will be collected through a cess on luxury items.

GST → tax evasion → unable to tax some people
→ people NOT paying true share.

Small Businesses
- cost of compliance is Higher.
- if total turnover < 2cr → Govt will levy flat rate of 15%.
- 'voluntary dwarfism'.

Companies → pay tax on profits.

Company → ↑ expenditure → ↓ profits.

↓

Base erosion and profit shifting. and misuse of DTAA, Related Party transaction

Indian co. → Reg. in Mauritius.

DTAA → profits of firms will be taxed → only in India or only in foreign companies.

→ Make parent company abroad

↓

They will purchase profit and shift profit.

↳ Related party transaction.

To avoid this

↳ Need automatic exchange of information

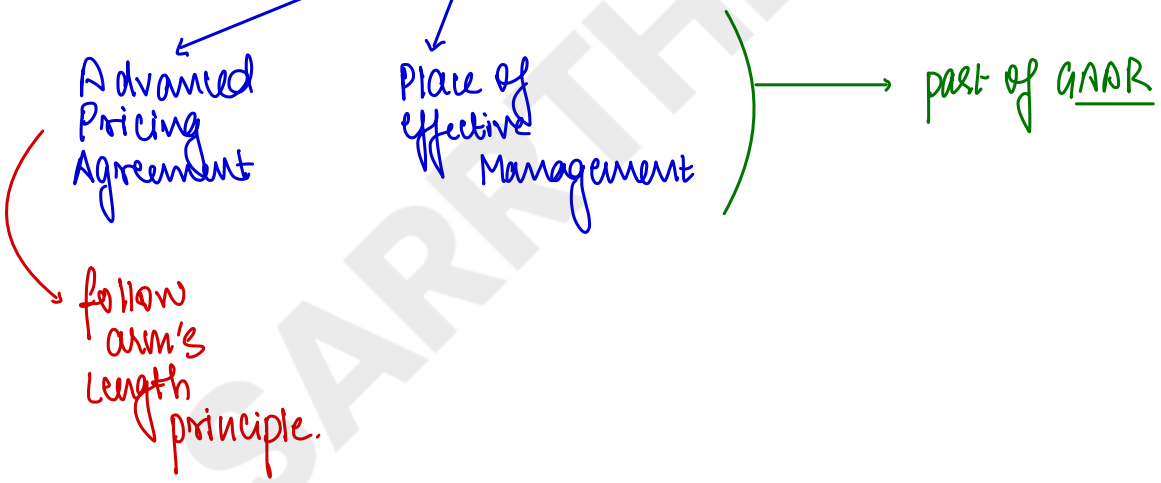
↓

G-20 and OECD countries.

GAAR: general anti avoidance rules.

- Parthasarathi Shome committee.
- To avoid 'Lose-Lose' situation of tax evasion and tax terrorism

↓



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