Budget Policy

Introduction:
According to ***Paul A. Samuelson***, a budget shows, for a given year, the planned expenditures of government programmes and the expected revenues from tax systems. The budget typically contains a list of specific programmes (i.e. education, welfare, defence, etc.), as well as tax sources (i.e., individual income tax, social-insurance taxes, etc.).

According to ***John F. Due***, a budget may be defined as a financial plan that serves as the basis for expenditure decision-making and for subsequent control.

A *'budget surplus'* occurs when all taxes and other revenues exceed government expenditures for a year. A *'budget deficit'* is incurred when expenditures exceed taxes. When revenues and expenditures are equal during a given period, the government has a 'balanced budget'.

When the government incurs a budget deficit, it must borrow from the public to pay its bills. To borrow, the government issues bonds, which are IOUs that promise to pay money at some time in the future. The government debt (sometimes called the public debt) consists of the total or accumulated borrowings by the government from various sources including public, banks, businesses, foreigners, and other non-federal entities.

Functions of Budget Policy:
According to ***Musgraves***, the major functions of the Public Finance or the governmental programmes can be grouped into three major classes, relating to allocation of resources, to efficiency in the use of resources and attaining economic stability and growth, and redistribution of income. These are discussed as follows:

(a) Allocative Function: The allocative function or activity arises out of the failure of the market mechanism to adjust the outputs of various goods in accordance with the preferences of society with the goal of maximising per capita real income. Allocative function refers to the process by which total resource use is divided between private and social goods and by which the mix of social goods is chosen. This is done by the budgetary policy. The budget policy ensures the optimum allocation of resources which will result on production and determination of public and private goods on optimum quantity or level. Also it will cause to remove the evils or shortcomings of price mechanism. As in price mechanism, the motive of profit maximisation is so strong that public and social welfare is altogether ignored, and the production of social goods and services, i.e., libraries, parks, schools, hospitals, etc., are avoided. Because in production of such goods and services the entrepreneur earns limited profit. Therefore, in these circumstances the government intervention becomes very necessary.

But to determine an optimum quantity of public goods is to some extent a difficult task because no one wants to pay the price for public goods rather they wants to be as a 'free

rider'. But this problem is solved through decision of taxes or expenditures. Such decision may be centralised or non-centralised.

Thus the problem of optimum allocation of resources for the production of social goods is resolved through budget policy.

(b) Distributive Function: The budgetary policy also affects the distribution of income in the community. The tax and expenditure measures are adopted to modify the existing distribution with a view to reducing economic inequalities. In this way optimal income distribution is brought about.

Through budgetary policy, the resource distribution and the optimum distribution of income and wealth can be ensured. Through government measures such steps can be taken whereby the resources can be diverted to the poor and depressed segments of the society. To remove inequalities, government mostly levies heavy taxes on rich people's income and provides subsidies on the goods of basic needs, i.e., food, housing, education, health, etc.

(c) Stabilisation Function: The budgetary policy can also be used to maintain a high level of employment, a reasonable degree of price level stability, an appropriate rate of economic growth and stability in the balance of payments.

In the stabilisation function of budget policy, we see the performance of the economy. In this function we trace the measures that how can the objectives of full employment be obtained. This function also ensures that inflation or deflation is controlled, and the GDP growth rate is higher or at least stable.

Importance of Budget:

(a) Assessment of Economic Conditions: Budget provides us the economic conditions of the concerned country, for example, if economy is growing, it means that all the sectors of the economy are growing. If the production of the economy is increases the incomes of the people will also increase. Thus when government assess the economic position of the economy and increase the expenditures, they will have multiplier effects pushing the level of income and employment.

(b) Financial Resources' Information: From budget, we come to know the financial position of the country, as it tells us about the total revenues, total expenditures, surplus or deficit. Moreover, it also tells us about how much revenue from direct and indirect taxes, from fees and surcharges to be earned. It also tells us about the extent of development expenditure to be spent on public sector development.

(c) Assessment of Budget Conditions: Through budget, the government can also assess the surplus or deficit in monetary terms to be attained next year. If the budget is deficit, the government will have to decide how these deficits could be met. Moreover, it could be observed from budget whether the provinces will be able to meet their expenditures or they will have to depend upon federal government.

(d) Expenditures' Distribution: What will be the proportion of expenditures on different sectors of the economy, this will be assessed through government budget. Moreover, the relative importance of different sector of the economy can also be judged from budget.

(e) Assessment of Income and Wealth Distribution: The budget gives us knowledge regarding income distribution in the country. Thus government can mobilise the resources through different policies and tools, i.e., taxes, expenditures, rebates, subsidies, etc., to the needy sectors and sections of the society through budget. Thus inequalities can be removed, when the assessment is easy regarding the incomes and wealth distribution in the economy.

(f) Indication of Economic Policies and Strategies: Budget also provides us knowledge regarding economic policies and strategies of the government. As from budget estimates, we can see whether the government is spending more on developmental purposes or on non-developmental purposes, whether the tax policy is encouraging or discouraging the entrepreneurs, etc. Similarly, it also assess whether the government preferences regarding expenditures are confined to one area or various sectors of the economy.

(g) Indication of Foreign Trade Sector: From the budget, we can see the direction of foreign trade of the economy, whether the government is providing facilities and rebates to exporters or import substitution strategy is being followed. The budget tells us whether the foreign loans are being used and what will be their repercussions on the economy.

(h) Importance for Consumers: Budget is a great matter of concern for the consumers, because the incidence of tax imposed by the government is on final consumers. Government generally imposes direct taxes (i.e., income tax, and corporate tax) on individual and corporate incomes; and avoids indirect taxes (i.e., sales tax) on consumer goods as it directly affects the consumers' purchasing power.

(i) Importance for the Producers: In under-developed countries, the entrepreneurs and the producers largely depend on the fiscal announcements in the budget policy. Government's tax cuts can boost the investment level in the economy; and encourage the private sector to come forward and invest in order to improve the employment level and the productivity level in the economy. Tax exemptions, rebates, tax holidays, and reduced import duties on industrial goods can achieve the employers' confidence in the economy and provide them the opportunity to achieve cheaper raw material and lower cost of production.

(j) Importance for the Employees: The working class of the society has also a keen interest in the government's announcements regarding increase in salaries of government employees and the overall increase in wage rates and pensions. The employees wait for the budget in anticipation of an increase in wages, salaries, and pensions with the fall in taxes.

Operation of Budgetary Process:
A budget is designed to improve adjustment of government activities in terms of the preferences of society by facilitating the comparison of conflicting programs and methods in the attainment of the goals as defined by preferences and to facilitate attainment of greater efficiency in the use of governmental resources. This, especially for the federal government, is an extremely complex one, particularly in establishing priorities for competing goals, for example, priorities for defence and the elimination of poverty. The task is extremely complex, even with the aid of the most modern systems analysis and computers.

As a consequence of these complexities, the operation of budgetary process has inevitably developed many shortcuts in order to be workable, which take several forms:

(a) Specialisation: The various agencies play a key role in determination of actual expenditure levels; each is concerned only with its own specialised work, with which its officials are familiar. The budgetary authority examines the requests. Furthermore, the government considers the direct needs of the particular activity as well as other activities.

(b) Fragmentation: the overall budget is fragmented into small pieces for most of the work, both at the level of preparation and at the committee level.

(c) Incremental Nature of Action: Existing programmes are not reviewed in detail each year. No one considers each year the questions of antitrust regulations, restructuring of postal department, etc. The presumption is that existing activities will continue unless there is strong evidence that their existence should be reconsidered.

Programme Budget / Traditional Budget vs. Programme Budget:
A primary function of the budget system is to facilitate evaluation of proposals and to compare the relative merits of various requests. Unfortunately, the traditional presentation of budget lacks the fulfilment of this task. Following are the disadvantages of a traditional budget:

(i) The usual budget is organised on the basis of agencies, without any related work coordination among them.

(ii) The budgets are organised in such a fashion as to stress inputs, without reference to outputs. The relationships between inputs and accomplishments are not established.

(iii) The typical budget is on a strictly one-year basis, without regard to future prospects or commitments arising out of the proposals included in this year's budget.

The programme budget is the replacement of the traditional budget, in which emphasis is given on performance. The local governments and to some extent the federal governments have also been introducing program features into their budgets. Following are the features of a programme budget:

(i) The ***programme approach stresses the end product***, such as eliminating poverty, increasing employment, increasing agricultural production yield, or aggressive approach regarding the achievement of the community goals, rather than the inputs of various types of materials and manpower.

(ii) The ***programme budgeting stresses the relationship between various outputs or programmes and the inputs necessary to produce them***, facilitating the use of techniques to analyse alternative programmes that will attain the goals and various alternative means of implementing them.

(iii) The ***programme approach seeks to be all-inclusive***, recognising all contributions that the activity makes and all costs incurred, regardless of the organisational structure.

(iv) It ***provides a more useful basis for evaluation*** of agency requests by department, and the Federal Government by concentrating on end products instead of inputs and by providing better information on costs and all benefits.

Planning-Programming-Budgeting Systems (PPBS):

The Planning-Programming-Budgeting Systems (PPBS) seek to integrate long-range planning of governmental activities and programming of specific activities with annual budgeting, making use of the programme-budget structure and of various quantitative techniques in the evaluation of proposals. Systems analysis and cost-benefit techniques are employed, with quantification of costs and benefits to aid in the selection of the best alternatives. This approach seeks to aid in defining the goals and in choosing among the goals, in specifying alternative programmes to attain the goals, in choosing the best alternatives, and, subsequently, in measuring performance. Planning is extended forward for several years, rather than focusing attention on the current year. Programming involves the statement of the relationship of inputs and outputs, under various alternatives, to accomplish the desired objectives.

The Planning-Programming-Budgeting Systems (PPBS) are extensively used in all federal units especially in defence.

Cost-Benefit Analysis:

Governments presumably consider both the benefits and the costs of programmes. But this consideration has often been haphazard, with little serious effort to quantify benefits or to include all costs and benefits. Governments' decision making is sometimes dominated by the 'absolute needs' approach, i.e., certain expenditure is imperative and must be undertaken regardless of cost. Sometimes it is dominated by the 'money first' approach, i.e., only a certain amount of revenue is available for the purpose and expenditures are therefore confined to this amount.

In recent decades, to some extent concurrently with the development of programme budgeting and PPBS activities, systematic analysis of benefits and costs has increased in importance. The first major applications were in the field of water resources (i.e.,

building up canals, dams, etc.), characterised by long-term investments and strong pressure groups.

'Cost-benefit analysis' can be defined as a systematic examination of the benefits and costs of a particular governmental programme, setting out the factors that should enter into the evaluation of the desirability of the programme and frequently analysing several alternatives for the attainment of the objective. Cost-benefit analysis is designed to ascertain the optimal alternative for the attainment of the desired goals, and to rank other alternatives.

Elements in a Cost-Benefit Study: Cost-benefit studies are typically undertaken within a particular governmental department as a preliminary to budget preparations, or as a continuing program to ascertain optimal expenditure patterns and budget recommendations. A cost-benefit study involves several major steps:

(i) Statement of Objectives: Obviously, the goals of the particular programmes must be defined. The goal may be very specific, such as that of an irrigation project, with the immediate objective of bringing 2,000 acres under cultivation by providing adequate water. The goal may be long term, such as to increase the country's potential food supply, may be much less well defined, especially in a situation of crop surpluses. Other projects have multiple goals; dams may have flood control, irrigation, navigation, electric generation and recreational objectives. The more sharply the goal can be defined, the greater the contribution that cost-benefit analysis can make to decision-making.

(ii) Statement of Alternatives: With many types of activities, there are various alternative ways of attaining the goals: different locations for irrigation facilities, different timing for parts of the project, different methods of construction. Cost-benefit analysis seeks to ascertain relative benefits and costs of the major alternatives.

(iii) Analysis of Benefits: With objectives defined and alternatives established, analysis proceeds to a consideration of the benefits. With many activities, this analysis involves determination of the physical units of 'output' from the activity and valuation of these units. Only those benefits should be included that alter the physical conditions of production or consumption for common persons or businesses; and those benefits should not be included in the benefits that reflect changes in prices and incomes arising out of the use of activities.

(iv) Analysis of Costs: Analysis of costs involves the same type of problem as that of benefits, although costs are more easily calculable. The direct costs included both capital costs and operating costs over the years. Indirect costs include those created for other governmental agencies, and overall costs to society not directly borne by the government. These are in a sense negative benefits. Without cost-benefit analysis indirect costs are often not taken into consideration. Air pollution provides an excellent example.

(v) Interest Rate: With many governmental programmes, especially those of types that lend themselves to cost-benefit analysis such as water and transport development, the

benefits will be obtained over a period of years. Likewise some of the costs will be incurred at the time the programme is undertaken while others will be incurred in subsequent years. But a rupee of benefits now is worth more than a rupee of benefits 10 years from now because of the interest phenomenon. In order to evaluate a particular project and to compare alternatives, therefore, an interest factor must be used to determine the present value of future benefits and costs; in other words the stream of consumption benefits and the stream of costs must be discounted back to the present for a comparison to be made.

(vi) The Criteria for Judgement: With estimates of benefits and costs discounted back to present value, the final question in cost-benefit analysis is the selection and use of criteria for evaluation. The basic comparison is between two streams: those of benefits and those of costs, both discounted back to the present. The alternative that provides the maximum excess of benefits over costs may be regarded as the optimal one, and any particular project that is the best for attainment of the goals and has discounted present value of benefits equal to the discounted present value of costs is warranted.

Essentials of A Good Budget / Balanced Budget:
Budget policy or fiscal policy has three major objectives:

- To insure that the actual rate of growth of the economy coincides with the potential rate of growth through maintenance of full employment;
- To attain a reasonably stable general price level; and
- To increase potential rate of growth if possible without interfering with attainment of other objectives of society.

Budget policy making depends on the economic conditions of the country. The level of expenditure on public works depends on the level of employment in the economy. If the country is facing financial depression, the country needs a boost in investment, which can be achieved through more development expenditure. In any circumstances, there are three standards of a good budget, i.e., optimal allocation of resources, distribution of resources, and stabilisation of the economy.

A good budget is one in which the assurance of optimal allocation of resources and factor should be maximum so that an optimum quantity of public good is obtained. In addition, a good budget should be in accordance with the conditions of demand and supply. Besides these considerations a good budget should possess the position of stability in the economy, i.e., the existence of inflation and deflation in the economy should be minimised if not removed.

Budget - Balanced or Unbalanced: There are two ways of balancing a budget, i.e., to cut the spending to match taxes or raising taxes to match spending:

(a) ***Cuts in government spending*** can be done in two ways:

(i) Either by reduction of purchases, or

(ii) By reduction of personnel.

Both options result in unemployment. Reduced purchasing would force government suppliers to lay off people. Lay-off of government workers likewise increases unemployment, obviously. More unemployment means fewer incomes to tax and more demands for government services such as unemployment compensation, food, medical aid, etc. Cutting welfare spending likewise reduces sales for food, medical service, rent, etc.

(ii) ***Raising taxes*** is politically unpopular. However, the economic effects of raising taxes may be less evident. Increased taxation, particularly federal taxes, takes money from local communities. Government economists may argue that the government spends the money back into the economy so there is not a net loss in the general economy. At least two things mitigate against economists' theories. One is that money spent to maintain the huge federal establishment of the country does not circulate back to local communities. Another is that the theory contains no time factor for how long it takes for the money to return, and how much money inputted will be returned back. Sending taxes to the Federal Government and expecting them back is like giving oneself a blood transfusion from the right arm to the left and spilling half of it on the floor.

Balancing the budget by either methods, or any combination, would result in hardship on the people.

This is the most complicated and controversial issue of public finance. Every government faces heavy criticism from social and political organisations regarding the public spending and taxation. In a period of inflationary pressures, fiscal policy seeks to lessen total spending, but its task is complicated by the wage-rate problem; the reduction in total spending must be accomplished in such a way as to minimise the additional pressure placed upon wages and thus upon prices from the cost side.

According to Professor Jack Winner, it is a wrong concept that government should present a balanced budget every year without considering overall circumstances of the economy. When the country is under heavy debt burden, it is quite often that the government paid off her debts by collecting more taxes. In such a situation, a surplus budget is desirable, but collecting taxes in excess of expenditures to reduce the debt is highly deflationary.

Rational fiscal policy calls for deficits when an expansionary stimulus is desirable, surpluses and debt reduction only when fiscal constraints are called for in a full employment and inflationary situation. From the above discussion, it would be evident that more employment, more public welfare and a balanced budget have no mutual relationship and cannot be attained at a time.