

Chapter 4 · Government Budget and the Economy

CBSE Class 12 Economics (030) · Part A Macroeconomics · Unit 4 = 6 marks · Ultimate Revision Sheet

60-SECOND RECALL

Budget	Statement of estimated receipts and expenditure for a financial year (1 April – 31 March)
Revenue receipt test	Creates no liability AND causes no reduction in assets
Capital receipt test	Creates a liability OR reduces an asset
Revenue Deficit	Revenue Expenditure – Revenue Receipts
Fiscal Deficit	Total Expenditure – Total Receipts excluding borrowings
Primary Deficit	Fiscal Deficit – Interest Payments
Key insight	Fiscal Deficit = Total Borrowings of the government

1. Meaning and Objectives

DEFINITION A government budget is an annual statement of the *estimated receipts and estimated expenditure* of the government during a financial year (1 April to 31 March).

Objectives (5)

1. **Reallocation of resources** — through taxes and subsidies, the government steers resources towards socially desirable production and away from harmful goods.
2. **Redistribution of income** — taxing the rich and spending on the poor reduces inequality.
3. **Economic stability** — controlling inflation and deflation through fiscal policy.
4. **Management of public enterprises** — funding and running natural monopolies like railways.
5. **Economic growth** — raising savings and investment through budgetary provisions.

2. Budget Receipts

THE TWO TESTS — this is the whole chapter **REVENUE RECEIPT** if it satisfies **BOTH**:

(a) creates **NO liability**, and (b) causes **NO reduction in assets**

CAPITAL RECEIPT if **EITHER**:

(a) it creates a liability, or (b) it reduces an asset

Type	Examples
Revenue — Tax	Income tax, corporate tax, GST, customs duty, excise duty
Revenue — Non-tax	Interest received, dividend and profits from PSUs, fees, fines, escheat, grants received
Capital — creates liability	Borrowings (domestic and foreign), small savings (PPF, NSC)
Capital — reduces asset	Disinvestment (sale of shares of PSUs), recovery of loans

THE FOUR THAT TRIP EVERYONE • Recovery of loans → **CAPITAL** (asset reduces)

- Interest received on loans → **REVENUE** (no asset change)
- Disinvestment → **CAPITAL** (asset reduces)
- Dividend from PSU → **REVENUE** (no asset change)

The government selling something is capital; the government earning from something is revenue.

3. Budget Expenditure

THE MIRROR TESTS **REVENUE EXPENDITURE:** creates **no asset** and reduces **no liability**.

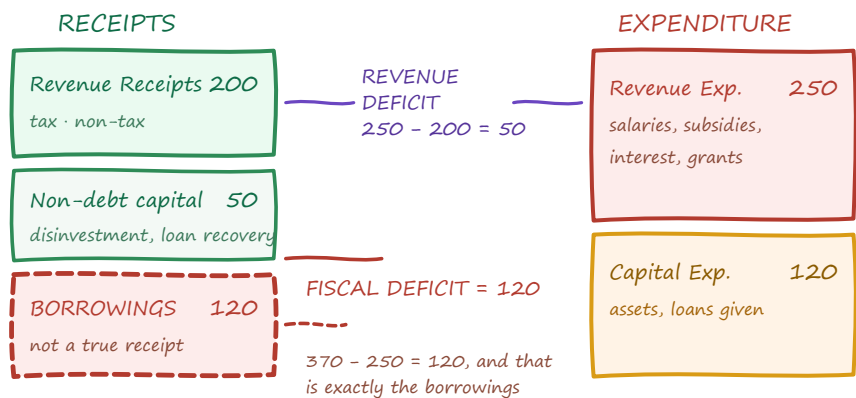
Eg: salaries, pensions, interest payments, subsidies, grants, defence revenue expenditure.

CAPITAL EXPENDITURE: creates an asset or reduces a liability.

Eg: construction of roads/schools/hospitals, purchase of machinery, loans given to states, repayment of loans.

TRAP Interest **PAYMENT** is revenue expenditure, but repayment of the loan itself is capital expenditure. The interest is a cost; the principal repayment reduces a liability.

4. Budget Deficits



THE THREE FORMULAS

Revenue Deficit = Revenue Expenditure - Revenue Receipts

Fiscal Deficit = Total Expenditure - Total Receipts other than Borrowings
or = Revenue Deficit + Capital Expenditure - (non-debt capital receipts)

Primary Deficit = Fiscal Deficit - Interest Payments

Deficit	What it indicates
Revenue Deficit	The government's consumption exceeds its revenue . It must borrow or sell assets to meet routine spending — a sign of dis-saving .

Fiscal Deficit	Total borrowing requirement of the government. High fiscal deficit means a debt trap , inflation and a burden on future generations.
Primary Deficit	Borrowing needed for reasons other than past interest . Zero primary deficit means the government is borrowing only to pay interest on past loans.

WORKED EXAMPLE Revenue Receipts 200 · Revenue Expenditure 250 · Capital Receipts 170 (of which borrowings 120) · Capital Expenditure 120 · Interest Payments 30.

$$\text{Revenue Deficit} = 250 - 200 = 50$$

$$\text{Total Expenditure} = 250 + 120 = 370$$

$$\text{Total Receipts excluding borrowings} = 200 + (170 - 120) = 200 + 50 = 250$$

$$\text{Fiscal Deficit} = 370 - 250 = 120$$

$$\text{Primary Deficit} = 120 - 30 = 90$$

USE THIS AS YOUR CHECK Fiscal Deficit must come out exactly equal to borrowings. Here both are 120 — that is not a coincidence, it is the definition: the deficit is what the government has to borrow.

So after computing FD, look back at the borrowings figure in the question. If they differ, you have made an arithmetic slip (or the question has given you inconsistent data). It is the fastest self-check in the whole chapter.

TRAP When computing fiscal deficit, borrowings are excluded from receipts. Students routinely include them, which makes the deficit come out as zero. If your fiscal deficit is zero, you almost certainly made this mistake.

5. Implications of Deficits

High Fiscal Deficit → problems

- **Debt trap** — borrowing to pay interest on old borrowing
- **Inflation** — deficit financing raises money supply
- **Foreign dependence** — external borrowing
- **Burden on future generations**
- **Crowding out** of private investment
- Measures to reduce deficit
 - **Raise revenue** — widen the tax base, improve collection
 - **Reduce expenditure** — cut non-development and wasteful spending
 - **Disinvestment** of loss-making PSUs
 - **Cut subsidies** that are not well targeted

6. Question Triggers revenue or capital?

Item	Classification
Tax collected (income tax, GST)	Revenue receipt
Borrowing from the World Bank	Capital receipt — creates liability
Disinvestment of a PSU	Capital receipt — reduces asset
Recovery of a loan given to a state	Capital receipt

Interest received on that loan	Revenue receipt
Dividend from a PSU	Revenue receipt
Salaries and pensions paid	Revenue expenditure
Interest paid on public debt	Revenue expenditure
Repayment of loan principal	Capital expenditure
Construction of a highway / metro	Capital expenditure
Subsidy on fertiliser	Revenue expenditure
Loan given to a state government	Capital expenditure
"primary deficit is zero"	Borrowing is only to pay past interest

MOST-ASKED BOARD QUESTIONS

1. [3-4M] Calculate revenue / fiscal / primary deficit from the given data.
2. [3-4M] Classify the following as revenue or capital receipts/expenditure, with reasons.
3. [4-6M] Explain the objectives of a government budget.
4. [3M] Explain the implications of a high fiscal deficit.
5. [1M] Fiscal deficit equals what? → **Total borrowings of the government**
6. [1M] What does zero primary deficit mean? → **Borrowing only to pay interest on past loans**

THE HABIT THAT SCORES — For every classification, write the **test you applied**: "Capital receipt, because it **reduces an asset** of the government." The two tests in Section 2 answer every classification question in this chapter — and the reason is where the mark sits.