FISCAL DEFICIT

Explaining Fiscal Deficit

– By Prof. Simply Simple

Simply Simple.in

FISCAL DEFICIT

The government needs money for its huge expenses.

We can broadly divide govt. expenses into two types:

1. Revenue expenses
2. Capital expenses

The money spent by the government for paying salary to its staff is revenue expense and the money spent for constructing a hospital is capital expense.

FISCAL DEFICIT

So how does the govt. meet these expenses?

The government finances its expenses by

1. **Revenue by direct and indirect taxes**
2. **Revenue by non-tax means include**
   - **<u>Revenue receipts</u>**

     These include dividends received from public sector companies, fees, fines, forfeitures etc.
   - **<u>Capital receipts</u>**

     These include sale of PSUs, recovery of loans, borrowings of the government

Revenue receipts are recurring in nature like the salary you earn while capital receipts are occasional in-flows like the proceeds you may receive on selling your house

Simply Simple.in

FISCAL DEFICIT

So where is the deficit?

- **The expenses that the government incurs is always more than the income it makes. This difference or deficit is known as "Fiscal Deficit". It is expressed as a percentage of GDP**

- **The financing of this deficit is known as "deficit financing"**

FISCAL DEFICIT

So how is this deficit financed???

- **Through government borrowings.**

  It is due to this reason we had included borrowings of the government as revenue in one of our earlier slides

OR

- **Through printing of additional currency notes.**

FISCAL DEFICIT

Which is a better option then???

- **Borrowing money from the market is a better option because if the government were to print more notes it would increase supply of money in the economy thereby reducing its “buying power” and causing inflation.**
- **Inflation would hurt one and all making the government un-popular.**
- **Therefore, borrowing from the market is a better option as it does not alter money supply. But this too cannot go on endlessly. To understand this let’s look at the next slide.**

Simply Simple.in

FISCAL DEFICIT

Government borrowings too have a limit

- **Borrowing money from the market cannot be an endless strategy purely because there is limited money in the market and needs to be made available for other borrowers as well**

- **Too much of borrowings will drive up interest rates making credit expensive and thereby putting pressure on prices.**

- **Hence, the only way to control the deficit in the long run is by spending less and earning more.**

Simply Simple.in

DISCLAIMER