

FISCAL DEFICIT



vEcoSys

Explaining Fiscal Deficit
– By Prof. Simply Simple



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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.



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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

- Revenue receipts

These include dividends received from public sector companies, fees, fines, forfeitures etc.

- Capital receipts

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



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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”



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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.



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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 unpopular.**
- ❑ **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.**



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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.**



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