

**PENANG SANGAM HIGH SCHOOL**  
**P.O.BOX 44, RAKIRAKI**

**LESSON NOTES**

**Subject:** Economics

**Year/Level:** 12

**Week 13**

<b>Strand</b>	3	Macroeconomics
Sub Strand	3.2	Government Budget
Content Learning Outcome	Explore the ways of financing budget deficit and their effects.	

Greetings to all...

In the last lesson we looked at the different types of central government budget.

That is a Surplus Budget, Balanced Budget and a Deficit budget. We will continue with the same sub-strand which is financing a deficit budget. When there is a **Deficit Budget** then only the economy will finance its deficit from different sources.

**Lesson Notes** ( Copy notes and examples in your note book)

There are 2 main ways of deficit financing:

1. **Internal Borrowing** ( Borrowings from within the country)
2. **External Borrowing** ( Borrowings from outside the country)

**Ways of Internal Borrowing**

Means of Internal Borrowing	Effects of Internal Borrowing
<b>1. Borrowing from the Reserve Bank of Fiji</b>	<ul style="list-style-type: none"><li>• This means that the <b>Reserve Bank will print more money</b> and as such more money will be spent in the economy thereby <b>increases domestic money supply.</b></li><li>• It results into <b>inflationary pressure</b> and this situation is called <b>Monetizing deficit.</b></li></ul>
<b>2. Borrowing from Private Sectors</b>	<ul style="list-style-type: none"><li>• <b>Government selling bond and securities to the private sector</b> as such money will be withdrawn from the commercial bank to purchase government bonds &amp; securities thereby <b>money supply decreases with an increase in interest rate.</b></li><li>• Increase in interest rate will result into <b>crowding out of investment</b> that is level of investment by private sectors will decrease.</li></ul>

## External Borrowing

Means of External Borrowing	Effects of External Borrowing
Borrowing from Foreign Financial Institutions such as World Bank and International Monetary Fund.	<ul style="list-style-type: none"><li>Borrowing from overseas will <b>increase national debts and debt servicing burden.</b></li></ul>

**Note: Borrowing is a deficit as it has to be repaid with interest.**

**Key terms:**

- 1. National Debts** – is what the central government owes to others.
- 2. Debt Servicing-** is the repayment of loan with interest.

**Example:**

Use the information given to answer the question that follow

	\$m
Government expenditure	20
Taxation receipts	15
Saving	10

- i. **Calculate** to show whether the economy is operating under **budget surplus or a deficit.**

**Government Budget = Government Revenue – Government Expenditure**

$$\begin{aligned} &= \$15\text{M} - \$20\text{M} \\ &= - \$5\text{M or } \$5\text{m deficit} \end{aligned}$$

- ii. **Identify one way** of deficit financing and **explain its effect** on the economy ?
- Internal Borrowing from the Reserve Bank- it will print more money resulting into an increase in money supply.
  - Internal borrowing from the private sector – government will sell its bonds and securities to the private sector resulting into crowding out of investment due to decrease in money supply and increase in interest rate.
  - External borrowing - borrowing from overseas will lead to increased national debts and increased debt servicing burden.