Hawking the Deficit

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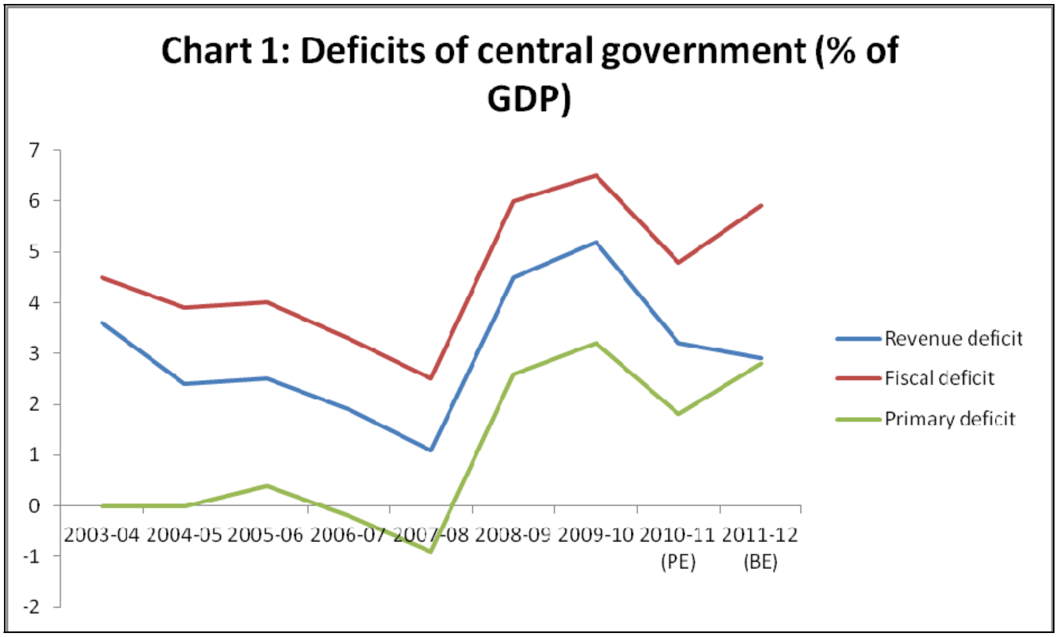
For more than two decades now, successive central governments have been telling the citizens of India that fiscal consolidation - to be achieved through reduction of the government's fiscal deficit - is an important, indeed essential, macroeconomic policy goal. The UPA government is no exception. It has repeatedly declared that it is committed to reducing the fiscal deficit and bringing it down to levels that were promised in the Fiscal Responsibility and Budget Management Act, 2003.

There are several reasons why the government persists in declaring this emphasis on deficit reduction. The usual argument advanced is that public borrowing will "crowd out" private borrowing and investment. This argument may have become passé in most policy discussions across the world, where the "crowding in" role of public investment is more widely recognised nowadays, but it still running strong in official policy circles in India. It is also well known that large fiscal deficits are anathema to global finance, which has become so significant in determining macroeconomic policy in India as elsewhere. Officials argue that large fiscal deficits not only lead to unsustainable build-up of public debt but also make the economy more vulnerable to capital flight.

However, this argument is open to question, especially when it emphasises rigid fiscal rules that do not take note of the cyclical behaviour of the economy and the need to use public spending to lift the economy out of recession or slump. Focusing on public deficit reduction is a particularly bad idea at a time when growth is slowing and many areas of capital and social sector spending remain underfunded. What makes the focus especially problematic is that the emphasis is not on mobilising extra resources to finance expenditures but on cutting spending and pushing "austerity" measures that would have negative multiplier effects in a context of economic slowdown.

But let us put to one aside the conceptual concerns with this argument. A pertinent question relates to how serious the central government actually is about its deficit reduction agenda, whatever may be its public pronouncements. In fact, the evidence seems to be the government, which has been proclaiming the need for sharp deficit reduction since the early 1990s, is not really committed to that goal. Instead, this is being used as a slogan to achieve other ends, particularly that of shifting some activities from public to private hands.

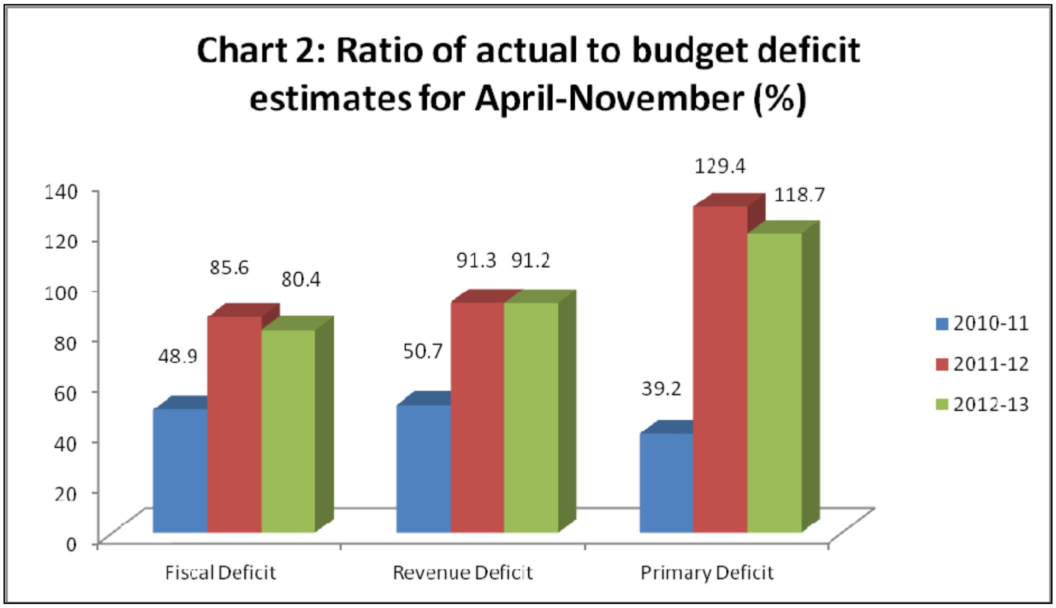
Chart 1 describes the movement of various deficit measures of the central government since 2003-04. It is evident that all measures move up sharply after 2007-08. While some increase in 2009-10 was only to be expected as a stimulus measure during the global downturn, the increase in the previous year 2008-09 was more likely associated with the increase in public spending before the 2009 general elections. The fiscal deficit widened further in 2011-12, and while the revenue deficit came down, it was still well above the government's own projections.



Despite this, the fiscal deficit target for the final year of the XIIth Plan (2016-17) has been set at an ambitious 3 per cent. This too, however, is a retreat on the government's previous claims. The government had in the past set the 3 per cent target for 2007-08, and then extended that deadline by a year because of the global financial crisis. Clearly the government is nowhere near meeting its own previous targets and may even be moving further away from them.

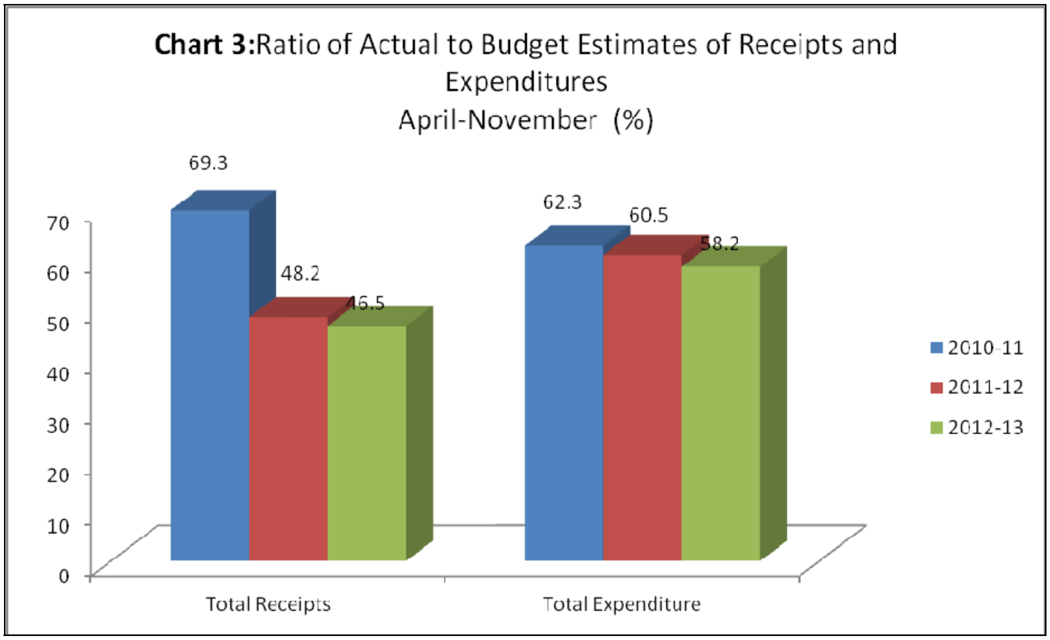
The government has admitted that it is slipping relative to its deficit reduction targets—but only marginally. The recently revised fiscal deficit target places it at 5.3 per cent of GDP in 2012-13, as compared with the budget estimate of 5.1 per cent. However, even this is likely to be an underestimate.

Consider the evidence on fiscal developments at the Centre for the period April to November 2012 released by the Controller General of Accounts. That shows (Chart 2), that the fiscal deficit over these eight months of fiscal 2012-13 is already at 80.4 per cent of the budget estimate. In just two-thirds of the year, more than four-fifths of the absolute fiscal deficit target has already been consumed. Add to this the fact that GDP growth over the year is now likely to be much less than predicted at the time of the budget, and the fiscal deficit is as of now on a trajectory that would take it much beyond the revised 5.3 per cent target. What is more, the fact that the revenue deficit in the first 8 months of the fiscal had amounted to 91.2 per cent of the budget estimate and the primary deficit (or the excess of expenditures excluding interest payments over revenues) was at 118.7 per cent suggests that it was the excess of non-interest expenditures over revenues that explains the runaway increase in the deficit.

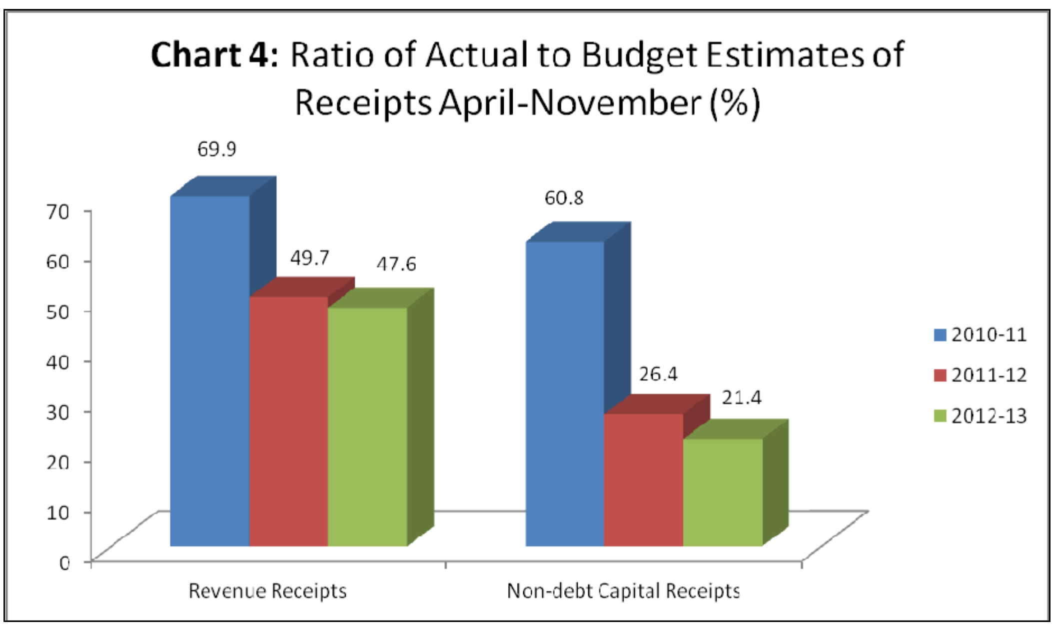


The government can take temporary comfort from the fact that the high ratio of the actual deficit during the first 8 months to the target for this fiscal year as a whole is not atypical. As Chart 2 shows, this was true of the previous year 2011-12 as well. But go back one more year to 2010-11 and the situation is completely different, with the ratio of the actual first-eight-months deficit to the projected deficit for the fiscal year amounting to just 48.9 per cent in the case of the fiscal deficit, 50.7 per cent in the case of the revenue deficit and 39.2 per cent in the case of the primary deficit. Hence, matters could have been different this year as they have been in the past. Not surprisingly, the fiscal deficit in 2010-11 was at a lower 4.6 per cent of GDP, as compared with 5.9 per cent in 2011-12 and a projected 5.3 per cent in 2012-13, which is likely to be exceeded.

What explains this tendency for the deficit to overshoot the target over this and the previous year. As Chart 3 indicates, the problem lies not in expenditures, which in the first eight months of 2012-13 were only 58.2 per cent of their targeted levels, and in 2011-12 at 60.5 per cent. In fact, in the ostensibly better performing year 2010-11, expenditure during the April to November months was at 62.3 per cent of the projection for the fiscal as whole. That is, expenditure during the first two-thirds of the year was less than two-thirds of the whole. Thus, the problem seems to lie on the receipts side, with total receipts during the first 8 months placed at 46.5 per cent and 48.2 per cent of the total in 2012-13 and 2011-12. As compared with this the figure in 2010-11 was 69.3 per cent.



So the government's 'fiscal failure' stems from its inability to realise an adequate share of the receipts it claims in the budget it will garner (Chart 4). Receipts (excluding borrowing) are of two types: revenues receipts (in the form of tax and non-tax revenues) and non-debt capital receipts. It is true that in both 2012-13 and 2011-12 the revenue receipts were only 47.6 and 49.7 per cent respectively over the first 8 months or two-thirds of the fiscal year. That figure was at 69.9 per cent in 2010-11. The revenue shortfall was one reason why the deficit tended to overshoot target. That could relate to poor revenue collection in the current year, but also (and possibly more importantly) because the projections in the budget were too optimistic in the first place.



The shortfall is even greater in the case of non-debt capital receipts, which include receipts from activities such as sale of spectrum, disinvestment or privatisation. Non-debt capital receipts during the first eight months of 2012-13 and 2011-12 were at a low of 21.4 and 26.4 per cent respectively of the projected receipts for the fiscal year as a whole. In 2010-11 as much as 60.8 per cent of such projected receipts had already been garnered by November.

So the evidence suggests that what the government considers its failure on the fiscal front in terms of "slippages" relative to target are not because of unexpected expenditures such as increased subsidies or compensation for "under-recoveries" by the oil companies. Rather, it is clear that the government's strategy of avoiding the taxation route to garner additional revenues and relying more on non-debt capital receipts to reduce its deficit or borrowing requirement is not working.

Despite this evidence, there are no signs of policy change in response to the changing situation. Putting emphasis on collecting revenues through taxation is still seen as undesirable because it would supposedly disincentivise private investment. This attitude is particularly marked in the GAAR episode. Meanwhile, this year the government is still far short of its hugely enhanced target of mobilising Rs. 30,000 crore from Miscellaneous Capital Receipts through disinvestment or privatisation. Nor has its initial effort to use the opportunity provided by the cancellation by the Supreme Court of 2G spectrum allocated at ridiculously low prices, to garner additional revenues by reselling them at much higher prices, been successful.

This suggests that - in order to meet or even come close to its own deficit reduction targets - the government could well attempt a fire sale of state assets over the coming two months. Already much of the nation's silver is being polished for sale. The government may even heed the reported recommendation of the Kelkar Committee on fiscal consolidation to combine stake sales in public sector enterprises with efforts to 'unlock the value of surplus land with them'.

Even these measures are unlikely to achieve deficit reduction targets, given the performance thus far. However, in the process, the stated deficit reduction agenda would have served to further the UPA's larger privatisation goals.

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