Is India's fiscal health headed for better times?

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Abstract: *The litmus test for the government in terms of the fiscal health of the economy it has presided over in the five years gone by, is the fiscal deficit or to be more precise, its primary fiscal deficit. With the next national election hardly six months away, it is time one appraised the performance of the government along the said lines. An analysis of the fiscal data suggests that the primary deficit is all set to linger over the comfort zone. How the government will leverage the favourable situation and whether the political executive and the permanent executive will see eye to eye in the matter is a question that needs to be answered. The researcher hopes that the two pillars of the administration will complement each other if they do not see eye to eye. One does not need to be a rocket scientist to discern that the political executive will settle for priming the populism pump. The recently-concluded state elections have driven home the message that populism is the go-to source for aspiring political parties. On his part, the researcher would suggest an acceleration in infrastructure spending even if it warrants deficit spending on the part of the government (by borrowing the funds required for the purpose, by selling securities), though. If the government resorts to deficit spending for the purpose of spending on infrastructure projects and not for the purpose of spending on populistic schemes, it will make better financial sense and better business sense too. Spending on infrastructure and that too rural infrastructure will ensure a better bang for its buck! The Indian experience has been that deficit spending on infrastructure projects particularly rural infrastructure projects, does not let down the economy in the medium to long term.*

Key Words: *fiscal health; leverage; primary deficit; fiscal deficit; primary deficit; gross fiscal deficit, budget; revenue deficit, GDP.*

1. INTRODUCTION:

With the present government all set to complete its innings in the first half of calendar 2019, it is time one took a look at its performance until now and in the few months that lie ahead in calendar 2019. The litmus test for the government in terms of the fiscal health of the economy it has presided over in the five years gone by, is the fiscal deficit or to be more precise, its primary fiscal deficit. With a little over six months lying ahead of it for completion of its term, the application of the litmus test at this point of time is bound to help in drawing inferences as close to reality as possible.

2. LITERATURE REVIEW:

- Government spending may be cut in other ways too (Tejvan, 2016) For example, a government may attempt to cut pension spending. For example, it may require people to work longer, leading to a rise in productive capacity. If a cut in public sector investment is attempted, it will have an adverse effect on the aggregate demand and the supply side of the economy. The government is often inclined to cut benefits and pensions because this can reduce spending without affecting the economic growth significantly. However, the strategy carries a cost -- inequality in society get worse.

- According to the International Monetary Fund (IMF), the government should consider raising the taxpayer base. It will help lower the deficit to three per cent of the GDP by 2017-18. This IMF statement comes in the wake of the GoI deciding to lower the fiscal deficit to 3.5 per cent in 2016-17 from 3.9 per cent in fiscal 2015-16. The decision is noteworthy in the backdrop of demands that the deficit goalpost be moved by another year in order to boost economic growth. But the general government deficit being closer to a higher seven percent by international standards does concern the supranational body. The looming higher pay-out for salaries and pensions warranted by the recommendations of the Seventh Pay Commission report requires an enlargement of the taxpayer base. By exploiting technology and Aadhaar to track down non-filers and tax defaulters, the enlargement of the tax base should become easier. The number of direct taxpayers in India being a mere 42 million, the Tax Administration Reform Commission has suggested enlargement of the taxpayer base to around 60 million taxpayers. On the indirect side, more taxpayers can be trapped, once the goods and services tax is implemented.

- Sustained high levels of fiscal deficit lead to a rise in the debt-GDP ratio. They also lead to a rise in interest payments as a proportion of revenues, reducing the productive expenditure pie (Rangarajan, 2016). As a percentage of net tax revenues to the government of India (GoI), interest payments have risen from 38.9 per cent in 2007-08 to 46.7 per cent lately. The Budget 2016-17 retains this level, despite an eroding revenue base resulting from higher levels of devolution to States. Without a conscious effort in place to contain fiscal deficit, this ratio will only keep rising. The impact of high fiscal deficit can be viewed from another perspective too. Under the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, the mandated target for the Central government is three per cent of GDP. The States taken together will account for another three per cent of GDP. Thus, the cumulative fiscal deficit of the Centre and the States will be six per cent of the GDP. Private business and government represent deficit sectors because they invest more than they save. They capitalise on the surplus of the household sector. Household sector savings in financial assets representing transferable savings used to be at 11 per cent of GDP. The mandated cumulative fiscal deficit of six per cent was thus consistent with the 11 percent of household savings in financial assets. But household savings in financial assets have since fallen to almost 7.3 per cent of GDP. This leaves a little over one percent of the household sector savings in financial assets for sectors other than the government (including public sector enterprises). Thus, the pressure on the government to achieve the target of three per cent of GDP is not surprising. Unfortunately, the government is yet to take a 'rigid' stand vis-a-vis fiscal deficit. The latter is almost one per cent above the mandated level for 2015-16. Flexibility should not lead to moving the goalposts – in this case, undercutting the basic principle.

- The Union Budget 2016-17 revealed a bias towards public spending (Rangarajan, 2016). Thus, it highlighted public spending in agriculture, infrastructure and social sectors. Pushing for public expenditure is but natural when the sentiment around private investment is weak. However, public spending gives rise to two issues: The first issue concerns the design of the schemes -- in other words, the ability of the proposed schemes to cater to the targeted needs of the sector concerned has to be ensured. Secondly and more importantly, the government should ensure that the schemes are effectively implemented in letter and spirit, on the ground. A collateral issue that will crop up is that a significant rise in capital expenditure on infrastructure will have to be financed by borrowings – over and above what the government has already set out to borrow.

- In India, efforts were made to curtail the fiscal deficit by both the central and state governments (Lekha, Fiscal Consolidation, Budget Deficits and the Macro Economy, 2016). The Fiscal Responsibility and Budget Management (FRBM) Act was enacted by the Government of India in 2000. It sought to reduce the fiscal deficit to three per cent of GDP by 2008-09. All the states in India have also introduced the FRBM legislation. The rationale behind the reduction in fiscal deficits emanated from the theoretical paradigms of macroeconomics. According to this, excessive fiscal deficits often trigger inflationary pressures in the economy. They raise the rate of interest and crowd out private capital formation. They also lead to balance of payments crises and in turn debt spiralling. However, considerable ambiguity exists about the link between fiscal deficit and macroeconomic activity.

- During the Eurozone crisis, many European countries cut government spending in an effort to reduce their budget deficits (Tejvan, 2016). For example, Greece, Ireland and Spain reduced spending. However, these measures led to a fall in economic growth, in turn leading to lower tax revenues and a higher debt to GDP ratio. However, this has to be viewed against the fact that the said countries could not devalue Euro, which carries a fixed exchange rate. In other words, the spending cuts proved much less effective in reducing the budget deficit. Nor could the countries pursue a loosening of monetary policy. The Eurozone being in recession rubbed salt into the wound. To sum up, apart from being less effective in reducing the deficit, the spending cuts aggravated the economic conditions.

3. RESEARCH METHODOLOGY:

The study is descriptive in nature and has relied on secondary data

4. Discussion and analysis

4.1 Primary fiscal deficit

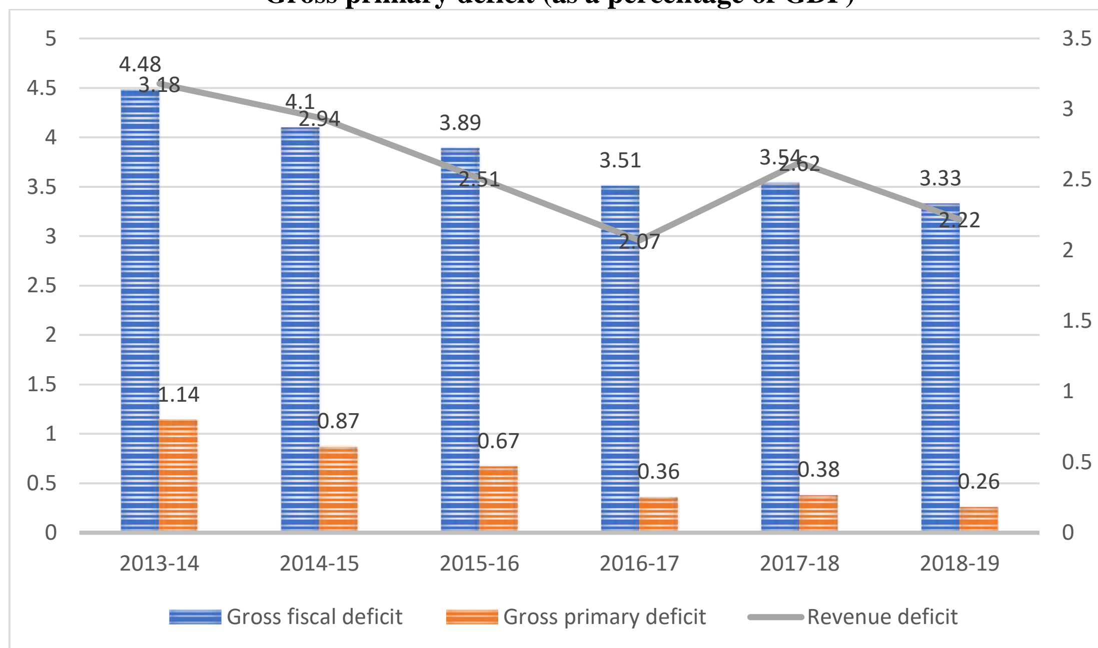
The researcher examines the primary fiscal deficit clocked by the government as a percentage of GDP during the period FY 2015 to FY 2019. The FY 2018 figures represent revised estimates while the FY 2019 figures represent budget estimates for obvious reasons.

Table-1
Gross primary deficit (as a percentage of GDP)

Year	As a percentage of GDP		
	Gross fiscal deficit	Gross primary deficit	Revenue deficit
2013-14	4.48	1.14	3.18
2014-15	4.10	0.87	2.94
2015-16	3.89	0.67	2.51
2016-17	3.51	0.36	2.07
2017-18	3.54	0.38	2.62
2018-19	3.33	0.26	2.22

(Source: Handbook of Statistics on Indian Economy 2017-18, RBI)

Figure-1
Gross primary deficit (as a percentage of GDP)



(Source: Handbook of Statistics on Indian Economy 2017-18, RBI)

4.2 Findings

Gross primary deficit is projected to decline to 0.26 percent of GDP in FY 2019 from a high of 1.14 percent of GDP registered in 2013-14. The corresponding figures for revenue deficit are 2.22 percent and 3.18 percent respectively. For four years on the trot, the gross primary deficit has registered sub-1 percent levels. For fiscal 2019 too, it is projected at the sub-1 percent level. Even the gross fiscal deficit, which factors in interest payments on the part of the government on national debt (accrued government deficit), is all set to slide to 3.33 percent of GDP in fiscal 2019. The revenue deficit too has replicated the downward trend during the period under review.

5. RESULTS:

With the gross primary deficit all set to linger over the comfort zone, the government has greater leeway and greater flexibility in exploiting the favourable situation. The question is how the permanent executive and the political executive would exploit the favourable situation, although the political executive will have the last word, for obvious reasons! The permanent executive would be inclined to bring down the deficit further or would reduce the tax burden, in that order (the best-case scenario). But the political executive may reject both the options, given that the parliamentary elections are around the corner. It would settle for priming the community care or community welfare pump or worse, it may settle for priming the populism pump, so to speak! With such appeasement of the electorate having become the new normal in our country, one would not like to call it a “worst case scenario”. Perhaps it would qualify as a normal scenario before long!

6. RECOMMENDATIONS AND CONCLUSIONS:

The researcher would suggest an acceleration in infrastructure spending even if it warrants deficit spending on the part of the government (by borrowing the funds required for the purpose, by selling securities). Disinvestment proceeds, as usual, will remain a mirage and hence deficit spending is the only way out. If the government resorts to

deficit spending for the purpose of spending on infrastructure projects and not for the purpose of spending on populistic schemes, it will make better financial sense and better business sense too. Spending on infrastructure and that too rural infrastructure will ensure a better bang for its buck! Spending on the so-called community care schemes or community welfare schemes has seldom reached the targeted beneficiaries fully and promptly! For the government, oversight of progress made in infrastructure projects is easier than the oversight of progress made in community care projects or community welfare projects.

Keynes may have favoured the use of deficit spending as a fiscal policy tool but globally this tool has by and large proved effective only when the economy concerned is passing through a recessionary phase! The 31st President of US, Herbert Hoover, who battled the Great Depression famously remarked “Prosperity cannot be restored by raids upon the public Treasury”. But during his reign, government and public works projects rose by 50 percent! Keynes did a Hoover, by stating that a fall in consumer spending can be offset by a corresponding rise in deficit spending by the government. It would bring down high unemployment levels. Once the high employment levels were dealt with, normalcy would return to the market and the deficit would be met. Additional spending by the government would lead to inflation but according to Keynes such a situation can be handled by raising taxes to mop up the surplus capital.

The Indian experience has been that deficit spending on infrastructure projects particularly rural infrastructure projects, does not let down the economy in the medium to long term. In the short term, a few hiccups may come to the fore though. As for handling the inflation engendered by deficit spending of this kind, one need not lose sleep! The Indian government and its policy-makers are past masters at taming such inflation!

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