

Don't ignore revenue balance

I've long been mindful of Roland Barthes' maxim "The birth of the reader is the death of the author." My Budget writings have been interpreted by many, including some *éminence grise*. So let me set the record straight and summarise my views. This was not a populist Budget. It reflected a continuing, if partially successful, attempt to maintain macro-fiscal prudence. The slippage in the fiscal deficit target for FY18 was not due to poor Budget formulation or design but a consequence of factors that were beyond the control of the Ministry of Finance. This reflects a structural weakness in the fisc, which must be recognised by all stakeholders within and outside of government for it to be successfully addressed.

I have expressed no view on the desirability or otherwise of specific tax proposals. I expect a modest increase in tax buoyancy over the next few years, but urge against complacency about the abundance of tax revenues tomorrow, as an excuse for slipping on prudence today. I am worried about the decline in non-tax revenue collections, and increases in recurrent expenditure that arise not from populism, but because of a jump in the government's recurrent expenditure commitments. In particular, I am worried that borrowing for recurrent expenditure, which had come down steadily across the tenure of this administration, has returned to 2013-14 levels.

By "recurrent" expenditure, I mean expenditure that the government expects to incur year after year. This includes wages and salaries, maintenance and consumables, interest on debt, pensions, subsidies, and transfers. Such expenditure should be financed entirely out of tax and non-tax revenues. In technical jargon, this is stipulated as the "Golden Rule" of responsible fiscal policy. In India, this has not been the

case for 30 years.

Commonsense dictates that current revenues should pay for recurrent expenditures. I would be foolish if I borrowed money to pay the salaries of my household staff, to purchase day-to-day necessities, to send remittances to indigent friends, or to pay EMIs on outstanding loans. Borrowing should be for investment

and, possibly, one-off consumption expenditures, not for recurrent spending. This year, borrowing for recurrent expenditure, measured by the revenue deficit, rose dramatically, accounting for 73.6 per cent of total borrowing.

Why does this common sense proposition vanish from the minds of many when it comes to government spending? Because, they confuse recurrence of the object and the outcome of expenditure with the purpose. Thus, many argue that government revenue

expenditure pays teachers' salaries, and these teachers produce human capital. Fine. Then, since a teacher is done with producing a cohort of human-capitalised students once the school year is over, they should be sacked. Why not? Because the teacher is expected to perform the same function next year and the year after on a *recurrent* basis, and this means we have to pay their salaries on a recurrent basis. Blood pressure medication prolongs a healthy life, but since the patient needs to buy it on a recurrent basis, he is in financial trouble if he has to borrow to purchase it. It is not the end object of expenditure that determines how it should be financed, but whether the same inputs need to be purchased on a *recurrent* basis.

Some argue that the Centre provides grants to states, which they use for investments, so these should not be counted as revenue expenditure. That's like

saying that if I donate money every year to construct a school building, it's fine for me to go and borrow money to make the donations. Again, the purpose of the grant does not matter; it is its recurrence, and the transfer of asset ownership, that requires it to be financed out of current revenues. To borrow for this, however noble the cause, is bad public finance.

Our Constitution underscores the importance of this distinction. Article 112 requires the government to distinguish expenditure on revenue account from other expenditure. This led to the specification of the revenue deficit (the difference between total revenue and total expenditure of the government), as a subset of the fiscal deficit. The reason for this constitutionally mandated distinction is that the income of the government — revenue — should pay for expenditures that were recurrent in nature, however noble or ignoble their purpose. Hence, the term "*revenue* expenditure." Today, we have succeeded in ensuring that states collectively do not borrow to finance recurrent expenditure, but more than 70 per cent of the Centre's borrowing is used to finance recurrent expenditure.

Countries that have ignored this maxim have, inevitably, faced a fiscal crisis as borrowing for recurrent expenditure leads to escalating interest costs and, as revenues fail to pay for recurrent expenditures, there are defaults in government obligations, delayed payments of bills and wages, and, ultimately defaults on loans. The genesis of the French Revolution lay in such a collapse, as did the end of the Mughal empire.

This has immediate relevance. The FRBM provisions outlined in the 2018 Finance Bill delete all references to revenue expenditure and the revenue balance, explicitly rejecting the recommendations of the FRBM committee on this score. I humbly plead that this may be reconsidered.



PUBLIC INTEREST

RATHIN ROY

The writer is director, National Institute of Public Finance and Policy and member, Economic Advisory Council to the Prime Minister