Slippage is structural, not populist

Important measures are required to get back on the path of fiscal reforms

THE FISCAL FRAMEWORK

RATHIN ROY

The government has not been able to adhere to its fiscal deficit targets for 2017-18. This was not unexpected. The bond markets had factored in fiscal slippage resulting in a rise in bond yields by 110 basis points over the last four months. Following the presentation of the Budget, despite the fiscal slippage, bond yields have risen marginally—the fiscal slippage was not as bad as markets feared.

I will focus on analysing why the slippage occurred. The fiscal deficit (FD) for 2017-18 is 3.5 per cent of GDP, 0.3 per cent higher than presented in last year's budget. The revenue deficit (RD) is 2.6 per cent of GDP compared to 1.9 per cent. It is the growth in RD that has driven the growth in FD. The RD/FD ratio was 58.76 per cent in Budget Estimates 2017-18 but is 73.78 per cent in the revised estimates (RE) presented in this Budget.

The central government has faced a long-term structural problem with the RD/FD ratio which has risen consistently from 4.5 per cent in 1981-82 to 74.3 per cent in 2012-13. This government's major achievement was to bring it down to 59 per cent in 2016-17. This is more worrying to me than the slippage in the fiscal deficit, however regrettable.

What has driven the rise in the revenue deficit? A macro-fiscal summary of the difference between aggregates projected in BE 2017 versus the RE presented yesterday shows that total expenditure is higher than projected by 0.47 per cent of GDP. Revenue expenditure is higher by 0.68 per cent of GDP and capital expenditure lower by 0.21 per cent of GDP. On the revenue front, tax revenues are in fact 0.28 per cent of GDP higher than projected in the 2017-18 Budget. There has been a precipitous fall in non-tax revenue, compared to projections, of 0.3 per cent of GDP. Even so, the two appear to have cancelled each other out, so it is unquestionably the case that higher than projected expenditure growth, not overall lower revenue, has driven the slippage in revenue deficit.

What has driven the rise in revenue expenditure? When we consider the different components and the increase/decrease in the revised estimates compared to BE of 2017, revenue expenditure is higher by ₹1.07 trillion. The ₹600 billion extra spent on other transfers is equal to the GST compensation paid to the states and is an important driver of the slippage. While it may be argued that this reflected poor fiscal marksmanship last year, one must recognise that the path to securing a consensus on GST has been a volatile one. For the rest, establishment expenditure is significantly higher chiefly due to an increase in pension expenditure, and unanticipated increases in defence revenue expenditure and interest payments. Thus increases in non-development revenue expenditures have driven the increase in the RD.

In the revenue front, income tax collections seem exactly on target and corporate tax collections have increased by ₹250 billion. Customs revenues have been lower than projected by ₹1.09 trillion, but a large proportion of this is optical, because countervailing duties have been subsumed in the IGST.

The 2017-18 tax revenues are higher in the RE than in the BE. It is non-tax revenue that has seen a short fall of ₹530 billion, which is almost exactly equal to the slippage in the fiscal deficit/GDP ratio, largely on account of much lower dividends from public undertakings and the RBI.

The fiscal deficit would have been on target were it not have been the lower than projected non-tax revenues. Getting 12 months of GST revenue instead of 11 would have been useful but is not a driver of the slippage.

Thus, stepping away from the noise and fury, it is clear that the fiscal slippage has not been due to electoral populism or the exigencies of transition to GST. The slippage reflects structural weaknesses in the fisc, rather than any significant strategic or operational errors in budget formulation.

Looking ahead, the outlook for 2018-19 is pessimistic. Tax revenues are not projected to rise by very much. Non-tax revenues are projected to fall even further and the reduction in fiscal deficit will require further expenditure compression. The RD/FD ratio is projected to fall to 66 per cent, still much higher than the 59 per cent targeted in 2017-18 reflecting continued fiscal stress as the government continues to borrow for recurrent expenditure rather than investment, and the share of interest payments continues to rise.

I would not worry about populist pressures as a result of the pronouncements in the Budget speech. An examination of the expenditure budget indicates much better targeting rather than an expansionary impulse in an election year. Thus agriculture specific schemes like the 'Pradhan Mantri Krishi Sinchai Yojana' and 'Pradhan Mantri Fasal Bima Yojana' have received significant allocations while allocations to other schemes have remained constant or declined. This is good fiscal management as it reflects prioritisation and focus.

So there has been a slippage in key macro-fiscal numbers which is worrying. But it is important to understand that this is not because of election-driven fiscal profligacy or poor budget formulation. Stakeholders need to realise that the macro-fiscal situation is a serious one and important structural measures are required to get back on the path of fiscal reforms. This is not something the finance minister can tackle without co-operation from other stakeholders — to increase non-tax revenue and control committed expenditure.

In this context, the finance minister's statement accepting the FRBM committee recommendations is welcome, though some specifics regarding a hard budget constraint, like a medium-term budgeting framework, and the institution of a fiscal council would have been significant confidence building measures. I would urge that these commitments are made soon, rather than waiting for the next budget.

The writer is director, National Institute of Public Finance and Policy