‘Tightening revenue deficit doesn’t seem the right course’

Weeks before the Union Budget, **PINAKI CHAKRABORTY**, director of the National Institute of Public Finance and Policy, New Delhi, sat down with **Subhomoy Bhattacharjee** to discuss the challenges ahead for the Indian economy. Edited excerpts:

What is the macro picture of the economy?

The macro picture is a lot better now than it was some time ago. If you look at the predictions of April-June 2020 about the economic shock from Covid-19, the actual impact has been far less severe. Going forward, I shall expect the improvements in goods and services tax (GST) receipts to sustain. However, it may be difficult to cover the gap in revenue created by the first two quarters. That is for the current year. For the next year, a high buoyancy and a positive growth should increase fiscal space.

What about deficit management?

For deficit management we should look at the combined deficit of the Centre and states. I suspect the aggregate state fiscal deficit shall be around 4.5-5 per cent of gross domestic product (GDP) this year. The Centre’s deficit will also be much higher than what was budgeted for financial year 2020-21 (FY21). There has to be a glide path of adjustment of the deficit and will demonstrate the government’s commitment to fiscal prudence. I suspect everyone understands that.

This leads us to the question of debt-GDP ratio. To what extent do you think there is need for concern on the projected rise in this ratio?

I would think that with the decline in fiscal deficit, the debt-GDP ratio could begin to decline soon. Since the debt-GDP ratio depends on the nominal value of GDP, we cannot ignore the denominator, which has contracted due to Covid. The fascinating story of public debt worldwide is that over the past 100 years, it has spiked in years of stress, but then came down. The gradual bulging of debt to GDP that you see, despite the long period of peace since the World War II, has happened because governments have stepped in more and more to provide a larger range of public services. That has kept government debt expanding gradually. Also, since governments have expanded, deficit management and debt management as policy tools have become critical. In the context of Covid, on debt to GDP ratio we should have a medium-term view.

Q&A

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What about the commentaries on the levels of revenue deficit vs fiscal deficit?

There is a general narrative that the government should expand capital expenditure and revenue deficit has to be tightened to make that possible. This year and for FY22 the situation is different. Since most of the ameliorative steps to cure for Covid, like expenditure on vaccines, have to be on the revenue side, asking for tightening it to make room for capital expenditure might not be feasible and does not seem the right course to take immediately. But in the medium term, certainly yes. There has to be, therefore, a prudent judgement on the level of revenue deficit for FY22.

On fiscal stimulus...

The fiscal stimulus given by countries have ranged over wide numbers. But the denominator used to calculate the stimulus is based on estimates of GDP, which does not factor in the impact Covid. Once the new GDP numbers come through for FY21, these percentages will change substantially upward. Since resource availability is directly linked to the level of GDP, that conceptual difference is important. My understanding is that in relation to actual GDP the Government of India has spent much more than the initial numbers that were thrown up based on the advance estimates of GDP.