Understanding the Anatomy of India's High Fiscal Deficit

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Extraordinary times require extraordinary policy responses. Against the backdrop of macroeconomic uncertainty in the time of the COVID-19 pandemic, finance minister Nirmala Sitharaman has presented a "significant" fiscal deficit number – which went upto 9.5% in FY21 – from a position of strength. Simultaneously, commencing a fiscal consolidation path to execute an "excessive deficit procedure" in the Union Budget 2012-22 to bring down the excess deficit of 9.5% of GDP in FY21 to 4.5% by FY26 is inevitable. However, this narrative of "deficit is good" in the time of a pandemic is welcome.

The fiscal consolidation through expenditure compression rather than increased tax buoyancy affects the quality of fiscal consolidation. From that perspective, allowing the fiscal deficit to rise above the threshold level of 3% of GDP, without significant expenditure compression, is welcome. However, the anatomy of the determinants of borrowings – decomposed by revenue uncertainties, economic stimulus-related spending, the narrowing of denominator GDP, lowering of rates of interest, etc. – would be interesting to understand with precision which components have exactly contributed to the aggregate level of high deficits.

The cleaning up of deficit incurred from off-budget liabilities through public sector undertakings is still a matter of concern. Such borrowings do not figure in the concept of fiscal deficit. However, the Union Budget 2021-22 has not introduced the deficit termed as "Public Sector Borrowing Requirement (PSBR)", integrating the borrowings incurred through public sector enterprises. The details of extra borrowings are kept in an Annexure in the Union Budget document.

The new fiscal rules

The new Fiscal Responsibility and Budget Management (Amendment) is tabled in the parliament today. The existing fiscal rules have been amended to incorporate the revised threshold of deficit to GDP. This is the third time the FRBM has been amended in India. As per the second amendment, the "revenue balance" was eliminated and clauses about "revenue balance" were incorporated in the Financial Bill to move away from the "golden (fiscal) rule" of zero revenue deficits.

Though there was a debate regarding the choice of deficit – whether revenue deficit, fiscal deficit or primary deficit was to be the "operational deficit parameter" in India – in the FRBM Committee Report with a dissent note from Arvind Subramanian favouring the primary deficit (fiscal deficit minus interest payments), the Union Budget 2021-22 reiterated that fiscal deficit is still the operational concept of deficit in India. However, primary deficit is useful to understand the current fiscal stance without the legacy of past interest payments (Table 1).

Table 1. Levels of Deficit

	2019-20	2020-21	2020-21	2021-22
	Actuals	**Budget Estimates**	**Revised Estimates**	**Budget Estimates**
Fiscal Deficit	933651	796337	1848655	1506812
	(4.6)	(3.5)	(9.5)	(6.8)
Revenue Deficit	666545	609219	1455989	1140576
	(3.3)	(2.7)	(7.5)	(5.1)
Effective Revenue Deficit	480904	402719	1225613	921464
	(2.4)	(1.8)	(6.3)	(4.1)
Primary Deficit	321581	88134	1155755	697111
	(1.6)	(0.4)	(5.9)	(3.1)

Source: Government of India (2021), Union Budget 2021-22 documents

The enhancement of "budget transparency" with regard to deficit numbers, presented in the 2021-22 Union Budget, is welcome. The Food Corporation of India's borrowing from the National Small Savings Funds will be stopped to bring in budget transparency. When FY21 fiscal deficit has reached 9.5%, the government envisions to borrow another Rs 80,000 crore in the next two months. For FY22, the fiscal deficit is pegged at 6.8% of GDP. The gross market borrowing will be Rs 12 lakh crore, which is 68.9% of total borrowings. The other sources of financing like National Small Savings Fund constitutes around 26% (Table 2).

Table 2. Sources of Financing Fiscal Deficit (Rs crore)

	2019-20		2020-21		2020-21		2021-22	
	Actual	**% of Total**	**Budget Estimates**	**% of Total**	**Revised Estimates**	**% of Total**	**Budget Estimates**	**% of Total**
Debt Deficit (Net)								
Market Borrowings (G-Sec + T Bills)	624089	66.84	535870	67.29	1273788	68.9	967708	64.22
Securities against Small Savings	240000	25.71	240000	30.14	480574	26	391927	26.01
State Provident Funds	11635	1.25	18000	2.26	18000	0.97	20000	1.33

Other Receipts (Internal Debt and Public Account)	44273	4.74	50848	6.39	39129	2.12	54280	3.6
External Debt	8682	0.93	4622	0.58	54522	2.95	1514	0.1
Draw Down of Cash Balance	4971	0.53	(-)53003	(-)6.66	(-)17358	(-)0.94	71383	4.74
Grand Total	933651	100	796337	100	1848655	100	1506812	100

Source: Government of India (2021), Union Budget 2021-22 documents

'Mini budgets' in continuum for economic stimulus

In the Union Budget, creating fiscal space for continuous support to ongoing series of economic stimulus packages was a matter of concern. In the regime of revenue uncertainties, the ambitious asset monetisation programme announced in the Union Budget to generate revenue proceeds need a supporting regulatory framework.

In the Union Budget 2021-22. the economic stimulus is announced not as a macroeconomic stimulus to revive the demand by providing huge cash transfers or a universal basic income (UBI). The concern was that if the people's propensity to save is greater than spending in the time of a pandemic, dropping "helicopter money" or a UBI in the hands of the people cannot lead to required demand stimulation. The statistics shows that precautionary savings by the private sector are on the rise during COVID-19. Instead of massive cash transfers, the Union Budget has provided targeted economic stimulus, especially to capital infrastructure and the public health sector. The total size of the budget for FY21 has increased to Rs 34.50 lakh crore. In FY22, total expenditure is pegged at Rs 35 lakh crore.

The emphasis on capital infrastructure spending for economic revival by increasing the capital expenditure for FY2021-22 by 34.5% to Rs 5.5 lakh crore is welcome. The estimates of capital expenditure for FY21 have been increased to Rs 4.39 lakh crore, as against the budgeted Rs 4.12 lakh crore. However, as percentage of GDP, the capital expenditure as share of GDP is still below 2%. The financing details of the other capital infrastructure projects announced in the budget through PPP models need further clarity.

The decision on intergovernmental fiscal transfers

The finance minister has announced a new centrally sponsored scheme (CSS) for enhancing public health infrastructure – the PM Atmanirbhar Swasth Bharat Yojana – with an outlay of Rs 64,180 crore over the next six years. This CSS will be in addition to the government's existing National Health Mission. The focus of a new CSS in the health sector will be on three areas – preventive, curative and well-being.

However, the finance minister has also announced a plausible convergence of CSS, as recommended by the Fifteenth Finance Commission report, which is tabled in the parliament today. This move will shift the composition of intergovernmental fiscal transfers from conditional grants to tax-transfer formula-based unconditional transfers (which is 41% of tax pool as recommended by the Fifteenth Finance Commission). The unconditional transfers provide flexibility to state governments to prioritise their spending, rather than designing "top down" programmes. However, designing a new public health infrastructure-related CSS can affect the fiscal autonomy of the states in dealing with the issues of the health sector, unless it is judiciously rolled out within the contours of cooperative federalism.

Union Budget 'nudging' the calculus of consent

Finally, the emphasis on state-level public infrastructure investment in the Union Budget, including the states like Kerala and West Bengal, invokes the calculus of voting behaviour. Does democracy determine public expenditure decisions? The Union Budget 2021-22 can answer this in the affirmative only in the forthcoming subnational elections.

Economists globally have analysed empirically whether positive public policy decisions by the dominant party in power or the economics of ethno-fragmentation and religion matter more for a median voter to choose their government. If it is the former, that the calculus of consent favours the party in power, then the Union Budget 2021-22 could effectively signal the benefits.

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