The uses of running a deficit

GROWTH STRATEGY. An interplay of fiscal and monetary policy would be needed to serve developmental goals

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RIGHT APPROACH. The government has chosen the path of increased capital expenditure to support growth PTI

The predominant narrative of the Interim Budget 2024 is the macroeconomic stabilisation function of a government in times of poly-crisis. The Finance Minister has reiterated that the fiscal consolidation is the primary instrument to achieve macroeconomic stability in times of war and geopolitical crisis.

In the Interim Budget, there is a conspicuous absence of a "formal" announcement of revisions in the fiscal rules — the revised threshold ratios of deficits and debts envisaged in the Amendments to FRBM Act (Section 4).

The announcement in the Interim Budget on capex growth rate at 11.1 per cent for FY25 is welcome. The capex is envisaged at 3.4 per cent of GDP in FY25. High deficits and debts in India have become a reality as a post Covid fiscal strategy to support economic growth, especially when the central bank has been focusing on inflation containment. India had a fiscal deficit to GDP ratio of as high as 9.5 per cent in 2020-21 (RE). It was important to keep the fiscal policy accommodative to support economic growth. The government has chosen the path of increased capex to support growth, as a post pandemic fiscal strategy, which has indeed affected the pace of fiscal consolidation. However, higher public investment has been a powerful determinant of private investment, it "crowds in" with a finite lag, though not instantaneously.

REVENUE RECEIPTS

The speed of fiscal consolidation is significant. Given the lower nominal GDP growth than expected, the government can meet its fiscal deficit target only through tax buoyancy, as severe public expenditure reduction can affect the growth recovery process. The revised estimates of revenue receipts — tax and non-tax — are promising, which are higher than the projected estimates. However, the challenge noted is the severe deviation in the projected and realised disinvestment proceeds. This affected the fiscal space. The disinvestment proceeds lack budget credibility in its projections. As against a 2023-24 BE of ₹61,000 crore, the realised proceeds were only ₹30,000 crore in 2023-24RE. The Budget Estimate for 2024-2025 is ₹50,000 crore, which is seemingly a realistic target.

The markets are keen to know not only the levels of deficit but also about the financing of deficits — how much the government will borrow in FY25. In FY25, government estimates its gross borrowing at ₹14.3 trillion to finance the deficits (net borrowing devoid of repayments estimated at ₹11.74 trillion, slightly lower than the previous year). This induced a short term rally in bond yield. To put the matter in perspective, in FY24, the net market borrowing was estimated at ₹11.8 trillion. This is the highest ever gross market borrowing, at ₹15.4 trillion in FY24, compared to only ₹7.1 trillion in FY20, and doubling to ₹13.7 trillion in FY21. In FY22, the gross market borrowing declined to ₹11.3 trillion, but rose to ₹14.2 trillion in FY23. In the post-pandemic era, the total outstanding borrowing of the government has been ₹54.6 trillion.

This is way ahead of the total outstanding borrowing of the government prior the pandemic decade. The RBI has manoeuvred the market borrowing stance by keeping the bond yields from rising sharply and also by avoiding the aggressive open market operations.

The cut off yield rate of 10-year bond was 6.14 per cent in FY20. In January 2024, it was around 7.17 per cent. Though the government can also finance deficits by printing money or through the creation of external debt, India recently has not resorted to these two modes significantly. Excessive use of any financing mode of fiscal deficit results in macroeconomic imbalances — money financing leads to inflationary pressures in the economy; domestic debt financing may lead to higher interest rates. However, the 'crowd in' narrative of increased capex has worked effectively for investor's confidence.

> **The comprehensive paradigm of beyond GDP is welcome, incorporating** climate change, blue economy and human development concerns.

STRUCTURAL REFORMS

Prior to capex strengthening through Budgets, the government adopted various structural reforms including the implementation of Insolvency and Bankruptcy Code 2016, and the major recapitalisation drive to clean the twin balance sheet crises. Despite these structural reforms, private investment has not picked up, and the government opted for enhanced public infrastructure capex into the economy. This post pandemic fiscal strategy of high debt substantiated through enhanced capex has been working well in times of low interest rate regime. Implementation of GST to avoid the cascading effects of indirect taxation has also been crucial for investment pick-up, though more reforms are required to rationalise the GST rates and slabs to strengthen the ease of doing business. The power sector reforms are also underway, closely tied to the fiscal consolidation.

Now with hawkish mode of monetary policy stance with increased interest rates consistently, public debt management is becoming costlier. India's public debt in the Modi regime has increased to over 80 per cent of GDP, supporting predominantly capex formation to support the growth recovery process. This is the impact of fiscal policy dominance in economic growth recovery process. A timely high deficit is important for growth.

High interest rate management by the RBI is affecting public debt management. Debt servicing is becoming costlier. However, the RBI cannot lower the rates given the global economic headwinds due to poly crisis. The interest payment expenditure to GDP ratio is expected to rise from 3.22 per cent in FY24 (RE) to 3.63 per cent in FY25 (BE). The phasing out of revenue deficit in this juncture will affect human capital formation. The revenue deficit is pegged at 2 per cent of GDP for FY25 as against the revised estimates at 2.8 of GDP for FY24.

Containment of revenue deficit is detrimental as a post pandemic fiscal strategy. The biggest challenge is to reduce the widening inequalities and unemployment, which requires high revenue expenditure.

Overall, it is a "humane" budget exercise as the Finance Minister pointed out — with fiscal consolidation on board, keeping the narrative of "Leave No One Behind". The comprehensive paradigm of beyond GDP is welcome, incorporating climate change, blue economy and human development concerns. However, it is too early to analyse if the Budget announcements are backed up by adequate allocations.

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