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NOTE

Managing Fiscal Deficit

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THE THREE MAIN GLOBAL rating agencies have drawn attention of Government of India to the fact that increasing fiscal deficit is becoming a drag on the economy.

Moody's said in December that fiscal deficit places a limitation growth. Standard and Poor said on February 7th that "a weak government fiscal position and slower economic growth will negatively impact India's sovereign rating." Fitch Ratings said on February 29th that India's fiscal policy is likely to remain restrained due to the government's fiscal consolidation goals. But the fiscal deficit shows no indications of softening.

First reason is that the Government has been able to garner a petty Rs 2.5k crore from disinvestment against target of 40k crore. Last year the Government had collected about Rs 100k crore from auction of spectrum. That had helped contain the deficit, at least, on the Balance Sheet. The income from spectrum was actually not revenue income. It was in the form of one-time sale of assets and should have been recorded as capital receipts. That would have led to higher fiscal deficit in 2010-11 and set an easier benchmark for the current year. Absence of such onetime income has only exposed the increase in fiscal deficit that had actually set in last year.

Secondly, the subsidy bill has increased. Price of diesel has not been deregulated leading to higher subsidy bill. The UPA Government has simultaneously embarked on increase in food- and employment subsidies, latter provided through the Employment Guarantee Programme. This is compounded by leakages.

Lastly, the tax collections are down. This is attributed to the global slow-down, The loss due to higher cost of imports is set-off against equally higher gains from exports. The real reason is that quality of government expenditures is fast deteriorating. Productive investments are down and consumptive expenditures are up as indicated by increase in the subsidy bill. This is leading to decline in growth rate and lower tax collections. This is also unnerving foreign investors and foreign portfolio investments are down. Global recession has made things worse as investors have turned risk-averse and fleeing from the emerging markets towards the United States. This impact of global recession is real though it is not the fundamental cause.

The basic philosophy of incurring fiscal deficit for promoting growth is quite sound. But the same fiscal deficit leads to opposite result when the money is used for consumption and leakages.

The politicians and officials have cleverly started milking government revenues behind the smokescreen of economic compulsions. The people are told that it is necessary to increase government expenditures to tide over the short term impact of the global crisis. But the money is leaked away.

It is time to adopt structural solutions. Fundamental problem is that the Government has implemented the model of borrowing-for-consumption (and leakages). This does not work in the long run. Main compulsion of the Government is to provide some relief to the *aam aadmi*. This objective is entirely laudable. It is not necessary to do this by increasing expenditures, however. It is possible to make policies that secure people's welfare while increasing tax revenues.

Past policy has been to impose income tax on the rich and use that money to provide consumption by the poor. The government should take a different approach. It should classify goods according to their social impact. Lower excise duty and service tax should be imposed on goods that are consumed by the poor such as bicycle tyre, coarse cloth, and cheap paper. This relief should also be given to internet, online education, etc. which are priority goods. Lord Meghnad Desai of London School of Economics rightly said in an interview: "The poor pay bulk of the taxes in India, which are collected in the form of commodity taxation." Goods such as chocolates, online cinema, mobile phones should be subjected to higher level of tax.

A similar difference should be made between goods produced by labour-intensive and capital-intensive methods. Job-eating industries such as bottled soft drinks, automatic power looms and large soap factories should be taxed heavily to enable the small and cottage industries to face their competition. A similar concession should be provided to units employing Dalits in large numbers. Such policies will provide relief to the people without requiring increased expenditures by the Government.

Government finances are in a mess not because of global slowdown but because of the shortsighted use of government expenditures for consumption and leakages. This will have to stop if the economy has to be put on the fast track again. □□□