



INFOCUS

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Fiscal Deficit! What to do?

“Democracy is the art and science of mobilizing the entire physical, economic and spiritual resources of various sections of the people in the service of the common good of all” – Mahatma Gandhi. On 6th July 2009, whole of India was eagerly waiting for the finance minister to present the first budget for the new term of government in the current economic situation. Stock market welcomed the formation of new government without the support of left by single day rise of nearly 15 percent and triggering a temporary trading halt. Lots of expectations by Share market, industries, common people and business men were expected to be fulfilled by Finance Minister. Mr. Mukherjee pointed out the following three challenges of the budget:

1. To lead the economy back to the high GDP growth numbers of 9% per annum at the earliest.
2. To deepen and broaden the agenda for inclusive development and to ensure that no individual, community or region is denied the opportunity to participate and benefit from the development process.
3. 3. To re-energize the government and improve delivery mechanisms.

Mr. Mukherjee sought to provide an ample dose of sops for the middle class. Further he emphasised on blending these sops with a massive fiscal stimulus and rural spending programme (to stimulate domestic demand) so that the economic growth can be put back on the track. This Union Budget is likely to leave more money in the hands of ‘common man’ through a massive step up in social sector outlays and marginal tinkering of personal income tax slabs. Alongside, it has done away with messy imposts such as Fringe Benefit Tax and the Commodity Transaction Tax, besides the 10% surcharge on taxable personal incomes above Rs.10 Lakh.

All these incentives would take a substantial toll on revenue and resultantly would lead to higher fiscal deficit (Rs. 400996 Cr) at 6.8 % of GDP as compared to 2.7% in the previous year (Budget estimate) and 6% as per revised estimate of 2008-09 on the account of stimulus packages. The budget estimates total expenditure of Rs 1020838 crore consisting of Rs. 695689 crore towards Non-

Infocus-Aug09

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plan (37% increase over 08-09) and Rs 325149 crore towards plan expenditure (34% increase). The increase in non-plan expenditure is mainly on the account of implementation of the Sixth Central Pay Commission recommendations, increased food subsidy and higher interest payments arising out the larger of the fiscal deficit in 2008-09.

Thus the Budget has expenditure exceeding revenue resulting in the huge fiscal deficit. The fiscal deficit is financed by obtaining funds from Reserve Bank of India known as deficit financing. The fiscal deficit is also financed by obtaining funds from the money market which is nothing but borrowings from banks. Borrowing money from the market cannot be an endless strategy purely because there is limited money in the market and thus needs to be made available for other borrowers as well. Too much borrowing will drive up interest rates making credit expensive and thereby affecting the overall demand in the economy. Other option to finance deficit is to print more money but it would increase supply of money in the economy thereby reducing its buying power and causing higher rate of inflation, it's a kind of invisible tax that reduces the value of the money you are holding. An increase in the fiscal deficit leads to increase in the current account deficit because as the demand in the economy rises, some of it gets converted into increased import demand. A large fiscal deficit could pose problems for the banking sector also, with a wide funding gap forcing the government to issue large amounts of debt, which will push up India's risk-free interest rate and depressing the price of government bonds, large volumes of which are held by banks. In spite of all these issues having a fiscal deficit is the only way to counter the impact of the economic slowdown by boosting up domestic demand when demand for Indian exports has been falling. Due to recession private investment also came down so step-up in public investment, especially increased expenditure in infrastructure development, could compensate for the fall in private investment.

A long-term solution is, however, to curtail the fiscal deficit. This can be done either by economising on expenses or by raising taxes. Looking at the prevailing recessionary situation, raising taxes may only reduce compliance. The other option is to reduce spending which is difficult, as the government is striving hard to boost the economy by increasing its spending on infrastructure and development activities. One way to plug the fiscal deficit is the disinvestment policy. With the aggressive disinvestment policy, the fiscal deficit may not be such a serious threat to the Indian economy, as generally perceived. The government may mobilise a whopping Rs 4 lakh crore an amount which may help in wiping out the country's fiscal deficit, by bringing down its holding to 51 percent in all the listed public sector firms. If the government plans to sell its stake in the listed PSUs maintaining its stake up to 51 per cent, the total amount that can be raised is \$94.77 billion (over Rs 4 lakh crore) and government has started to identify such PSU's for disinvestment. As on July 28th, finance minister, Mr Pranab Mukherjee, while replying in the Rajya Sabha during Question Hour said, "PSUs with high profits are under consideration and as soon as markets are in good shape, we will list them. We want to gain maximum advantage of the markets once they get back in shape."

Besides listed PSUs, as per the disinvestment policy, the government is also planning initial public offers (IPOs) of several unlisted PSUs as well such as NHPC, OIL, Coal India Ltd, BSNL, RITES, IRCON International. The disinvestment process, which came to a virtual halt during the last 3-4 years due to opposition of Left parties, may pick up speed considering the fact that this time the new UPA government has been formed without the Left support.

Fiscal deficit should be kept in control to attain high growth rates. Low fiscal deficit is seen by investors as an indicator of good governance and can help attract large levels of private domestic and foreign investment because fiscal deficit-led growth strategy is beneficial only in the short run.

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Infocus-Aug09

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Infocus-Aug09

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