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THE DEFICIT PROBLEM

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

Nearly 18.5 per cent of the Centre's fiscal deficit — the gap between its total spending and revenues from taxes and other non-debt sources — in 2019-20 is expected to be financed from small savings schemes collections, as against 12.6 per cent in 2016-17 and only 2.5 per cent in 2013-14. Further, the National Small Savings Fund (NSSF), which aggregates the receipts from these mainly Post Office-run schemes, invested Rs 70,000 crore in the Food Corporation of India (FCI) during 2016-17 and another Rs 65,000 crore in 2017-18. All this points to the fact that the Centre is increasingly taking recourse to non-market borrowings for meeting not only its own deficits, but also the requirements of parastatals from the FCI and National Highways Authority of India to Air India.

One way to view the above is that diversification of funding sources is a good thing: To the extent the Centre and its extended arms raise less resources from the market, there is that much-reduced pressure on private sector borrowers. Also, the NSSF monies have to ultimately be invested somewhere in order to pay small savings subscribers. If these are deployed in government securities, why should that be a problem? This argument, however, misses the point. The real issue today is with deficits per se and not how they are financed. Sajjid Chinoy of the American investment bank, J.P. Morgan, has estimated India's total public sector borrowing requirement — which includes that of the Centre as well as state governments and parastatals — at 8.2 per cent of the GDP during 2017-18. Given that the total financial savings in the economy, according to official data for the same fiscal, amounted to 19.9 per cent of the GDP, it means the public sector is cornering well over a two-fifths share of the annual surplus with households and firms today. Does it matter beyond a point, then, whether this cornering is happening via banks and bond markets or the NSSF? So long as public deficits remain at the unsustainable levels they are at now, the private sector will continue getting crowded out and forced to pay interest rates that deter it from making productive investments.

Further, there is a cost to deficit-induced borrowings. For the coming fiscal, the Centre's own interest payments — including on so-called special securities issued to public sector banks for recapitalisation or to the FCI, fertiliser and oil marketing companies in lieu of cash subsidy — are budgeted at Rs 6,65,061 crore, which is 33.6 per cent of its revenue receipts and 23.9 per cent of total expenditures. Clearly, this cannot go on. The Narendra Modi government squandered the political capital it had to fix the deficit problem, whether through aggressive rationalisation/targeting of subsidies or reforming state-owned undertakings and banks by outright privatisation rather than recapitalisation. The next government will probably not have the luxury of dithering.

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