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Adhering To Fiscal Deficit Target

What is the issue?

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- India is witnessing a sharp deceleration in economic growth.
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- Fiscal stimulus is being touted as a policy measure to revive the economy.
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- However, a deeper understanding in terms of 'fiscal deficit' reveals why fiscal stimulus is not the right option.
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Why a slowdown in economy?

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- There were many transient factors like the GST and demonetisation impacts for the current slowdown.
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- But besides these, one of the prime reasons is the steady and sharp **decline in the investment rate**.
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- Notably, public investment in recent years has shown a small rise.
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- So the lowering investment rate has largely been due to the **decline in the private investment rate.**
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- The Gross Fixed Capital Formation (GFCF) rate has come down in the recent quarter.
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Why not a fiscal stimulus?

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- A fiscal stimulus is one in which the government spends more from its own pocket or slashes tax rates to boost a sluggish economy.
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- This results in more money in the hands of consumers, and as a result spending goes up, thereby encouraging demand and growth.
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- There are opinions that a strong fiscal stimulus through an increase in **public investment** and a **relaxation on the fiscal deficit** obligation is needed.
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- However, an understanding of the real factor behind slowdown as said above, demands policy initiatives for raising the **private investment.**
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Why is relaxing fiscal deficit target risky?

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- **Borrowing space** - The prime focus of fiscal deficit targeting is to ensure that the private sector has sufficient borrowing space.
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- Increasing government debt and increasing interest rates reduces the credit available for businesses.
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- Also, government selling its securities, such as Treasury bonds to finance its debt absorbs the available funds from the private sector.
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- So, widening fiscal deficit would only narrow the borrowing space and reduce private investment at a time when it has to be boosted.
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- **Debt-GDP ratio** - Government has set a target of debt-GDP ratio at 60% in 2023 from the present level of 70% .
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- This requires the Centre and States to contain their debt-GDP ratios at 40% and 20%, respectively.
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- This is achievable only by limiting the fiscal deficit at 3% of GDP in the first three years and 2.5% in the next two years by the Centre and States.
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- **Revenue deficit** - Over 60% of the estimated fiscal deficit at the Centre in 2017-18 (1.9% out of 3.2%) is revenue deficit.
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- At the State level also , the revenue deficit is only expected to increase.

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- This is because of the impact of loan waivers, additional interest payments on account of UDAY scheme, and pay revision as per 7th pay commission.
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- Given all these, any additional fiscal stimulus measures would only widen the already increasing revenue deficit.
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What lies ahead?

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- India's economic history is replete with adverse effects of fiscal expansion on inflation as well as the balance of payments.
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- The huge fiscal expansion in the late 1980s and 2008-09 have led to some serious economic crisis besides the benefits.
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- Clearly, the solution to the current slowdown in growth lies in:
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i. reviving private investment.
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ii. recapitalising banks to enable them to lend more.
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iii. speedy completion of stalled projects.
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- The fiscal deficit rules evolved are consistent with the level of savings and the demands of the various sectors on those savings.
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- So, fiscal prudence is crucial for sustaining growth over an extended period.
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- In this challenging economic situation, any aggressive attempt to widen the fiscal deficit would only worsen India’s economic problems.
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Quick Facts

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Fiscal Deficit

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- Fiscal deficit is the difference between total revenue and total expenditure of the government.
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- It is an indication of the total borrowings needed by the government (so as to finance the deficit).
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- Fiscal deficit takes place either due to revenue deficit or a major hike in capital expenditure.
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Gross Fixed Capital Formation (GFCF)

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- Gross fixed capital formation is essentially the net investment.
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- GFCF refers to the net increase in physical assets (investment minus disposals) within the measurement period.
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- It does not account for the consumption (depreciation) of fixed capital, and also does not include land purchases.
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- It is a component of the Expenditure method of calculating GDP and measures the net increase in fixed capital.
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Source: The Hindu

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