Lockdown and Fiscal Management

What is the issue?

- One of the biggest casualities of the lockdown is the government.
- All governments need money to function and if revenue does not increase it is hard to meet committed expenditure.

What is the reality?

- For the Central government, there is a solution in the form of higher borrowing, for which it must ideologically steer away from FRBM.
- But States find it hard to manage, and end up cutting discretionary expenditure.

Why is there a decline in tax flow?

- Income tax collections are lower by around ₹35,000 crore. There are three reasons for this.
- There were **job cuts** by several corporates, which directly meant a lower salary bill and hence tax payments.
- The companies have **lowered the salaries** of their staff by different scales for the year.
- All companies disburse their variable pay to their employees in the first quarter.
- The fourth-quarter as well as FY20 results of companies showed decline in both the topline and bottomline.
- Hence, the payouts to employees were lower, which gets reflected in a one-time loss for the government.
- There is a continuation in the trend of **falling sales and profits** of companies for Q1 FY21.
- With profits declining, the tax outflow would come down, which is reflected in the lower collections so far.
- It may be hoped that there would be some pick-up in Q3 and Q4.
- This can help steady collections and avoid a sharp fall in this period.

Why is there a shortfall in GST collections?

- The major casualty is the GST, where there has been a 50% decline.

- [The GST is a tax imposed on all goods and services.]
- For tax collections to increase, consumption should go up.
- The localised periodic lockdowns have ensured that households have only shopped the essentials, which have lower GST rates.
- For the first two months, e-commerce was not allowed to deliver non-essentials.
- The result was less spending and lower revenue for the government.
- With limited removal of restrictions until September, it is unlikely that there will be any pick-up and the government will witness sharp fall in GST collections.

Why is there a trade deficit?

- The trade deficit has been widening with **imports declining** faster than exports due to a sharply falling economy.
- This lowers demand as well as crude prices, customs collection too have declined by around ₹24,000 crore.
- This does not look like it will be compensated for in the future, as imports would continue to move in a downward trajectory.

Is there any decline in excise collections?

- The Central excise collections have more or less been maintained.
- This can be attributed to the government increasing the duty on petrol and diesel as well as sin products.
- If these items were subsumed under the GST, the government would have had no control over the collections.

What would be the economic effects?

- **State budgets** - The first consequence of such sharp slippages in meeting targets is that the State budgets would get affected.
- During the first quarter, the transfers to States were ₹1.34 lakh crore as against ₹1.49 lakh crore last year.
- The shortfalls in the Centre's revenue would translate into the same for States.
- This in turn have to cut back on expenditure.
- **Expenditure** - The second implication is that the Centre has to take a tough call on the expenditure side.
- So far this quarter, the total expenditure has been higher by around 13% at ₹8.16 lakh crore.
- This is mainly due to the relief expenditure invoked, that was said to be

outside what was budgeted . Two possibilities exist.

1. There can be a cut in capex during the year even though the government has enhanced such allocations to keep spending up.
2. There could be some sharp cuts in subsidies.

- As the government has announced it is giving free foodgrains to the poor for six months, it would remove the need to provide any food subsidy separately.
- This is why the food subsidy bill this time is much lower than that of last year.

How would borrowing help?

- Higher borrowing will be necessitated due to a higher fiscal deficit.
- The government slashed interest rates on small savings drastically in April, so there will be a lower allocation of funds.
- Hence higher market borrowing will be necessitated.
- The government has already increased the borrowing programme from ₹7.8 lakh crore to ₹12 lakh crore for the year.
- Such borrowing will definitely have a bearing on bond yields.
- This is why they are still quite intransigent in the downward direction, even though there is surplus liquidity.
- The RBI has brought in a new benchmark security that had a lower yield.
- The market remains uncertain.

Source: Business Line

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