Indian Economy: Some Contemporary Perspectives

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Lecture No. 34

Indian Economy - Fiscal Policy 1

Hi, everyone. So, now we are going to start our new topic. In this particular session we will be talking about fiscal policy. So, we have already discussed in detail about the monetary policy. So, now it is time to discuss the fiscal policy because without completing both legs of the policy, it will not be good to go ahead with any topic. So, I thought I should spend at least at least two sessions on fiscal policy, so that we will have at least some idea about what is in India context to how we try to measure the fiscal policy? What are the indicators that we should be focusing on?

So, if you read the economic survey, a chapter 3 in volume 2 mentions about the fiscal aspects and it is always important that we should at least understand the indicators mentioned over there and it is also important that not from the perspective of only understanding, but we should also know about where the government is trying to improve? What are the areas where government is focusing on? So, fiscal policy gives the indication that what are the important areas where the government is looking for either expanding their capacity or looking for further enhancement of or the strengthening of the sector or the industry.

In economy, if you want to understand the policy perspective, so you have the monetary and fiscal policy. So, countries which are independent not part of any I would say currency union or any trade union, if you are not part of any kind of monetary union, then it is always good that you have the control on both monetary and fiscal policy. So, from that perspective, this particular session is all about understanding the basic concepts of the fiscal policy and we will also try to see what are the regulatory frameworks that we have devised to put a check and also to facilitate the fiscal expenditure in the country. So, this particular session is all about that.

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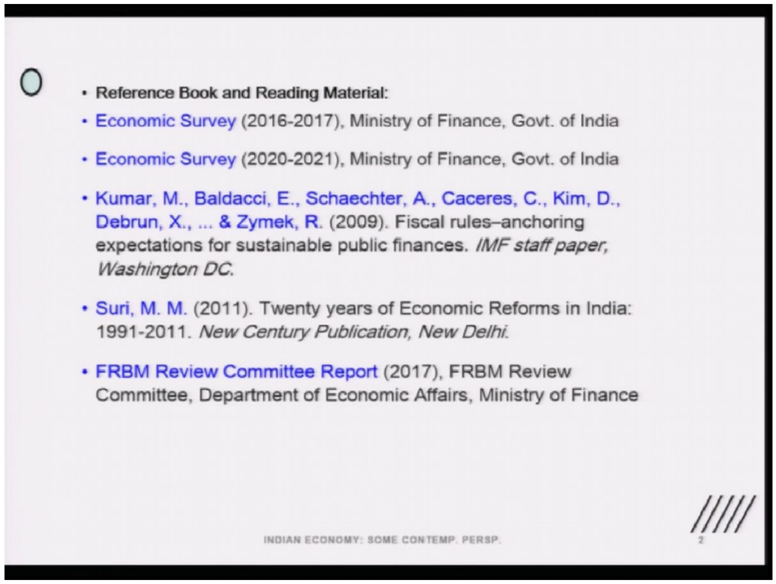

For references and reading, so I have referred Economic Survey 2016-17. For 2016-17 it is important because for the first time, I saw that a private chapter was devoted on the fiscal aspect, basically the performance of the states on the fiscal budget management. And also, I found economic survey 2020-21 very important, because it highlights the recent changes that we have experienced in the last one year and it also highlights some of the aspects of those developments.

So, it is always important that we should update ourselves with the recent developments. And also, I have referred a very good paper by Kumar at all and it mentioned about the fiscal rules anchoring expectations for sustainable public finances. So, fiscal policy falls in the area of I would say public finance, where you study about the expenditure and the revenue pattern that how much government is planning to spend and how much it is going to get.

Since it is a very broad area, so I may not be able to touch each and every aspect of the fiscal space, but at least by half an hour session, we will have at least some understanding about the fiscal policy. So, in this regard Suri I have referred that we have already referred in the past. There is an important committee which is called the FRBM Review Committee, it is the report is available, it is quite bulky, and it has several volumes.

So, I have tried to refer and it also provides a very good understanding an overview of the journey of the FRBM Act, how it was done? What was the intention and how the further improvement will lead to betterment of the fiscal management in the country? So, these references, those who are interested, they can refer these references and at least wherever I have referred any other reference I have cited. So, if you are interested in reading those or exploring those links, again, you can always do that.

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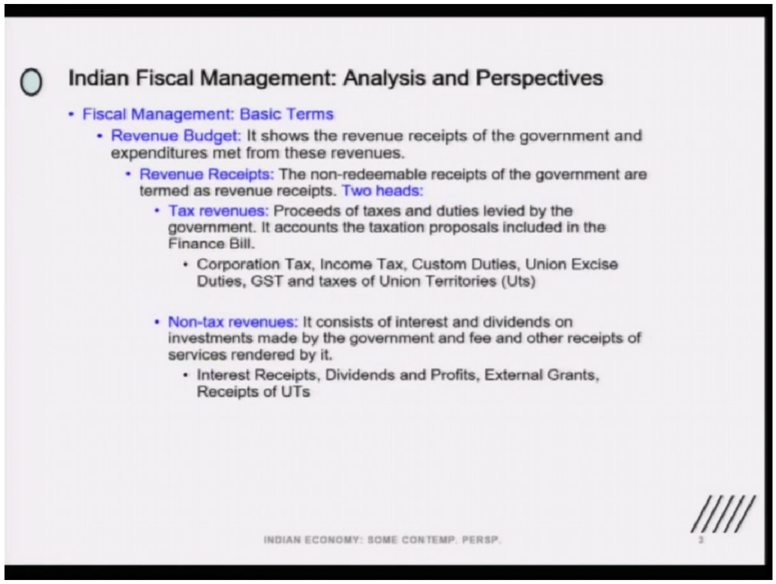

So, let us start. So, here we have the fiscal management. So, I have given the title Indian Fiscal Management Analysis and Perspectives and in this we have two important things. One is called Revenue budget and another is called Capital budget. In the revenue budget, we normally talk about the revenue receipts of the government and the expenditure. So, what is the expenditure side and what is the revenue so, that we talk about. So, revenue received basically how much the government is going to get from different sources. There are tax sources which mean that the tax revenues and there are non-tax revenues.

So, one thing you have to understand that in the setup that we have, we have two types of taxes direction and whatever amount of tax you pay for buying any or availing any services that goes into the government's account and the some of that because these are non-redeemable receipts of the government you cannot claim and ask for reimbursement or repayment and it is excess of what you are supposed to pay, it is just an obligation of paying the taxes.

So, it becomes really, really important to note. So, tax revenues proceed of taxes duties levied by the government. It accounts the taxation proposal included in the finance bill. Under this, you have the corporation tax, which is the tax being imposed. Then we have the income tax, customs duties, union exercise duties, GST, and taxes of union territories. So, all these are included in the tax revenues.

There are other avenues where the government gets money. So, that is called non-tax revenues. It consists of interest and the dividends on investment made by the government and the fee and other receipts of the services rendered by it and it is the interest received, so whatever loan it sanctions or whatever loans it facilitates to other multilateral or bilateral loans that it facilitates whatever rate of interest it gets on that dividends.

Dividends and the profits that, so whatever we have the public sector enterprises functioning in India and whatever amount of money they generate as a profit they give it every year to the government. So, that is also added to non-tax revenues. Then we have external grants also, coming and without any kind of guidance, and receipts of the Union territories.

So, Union territory directly report to the Indian government and they are managed by the by the Union Government. So, whatever surplus if they have in any way they will be giving to the Union Government. So, these are the sources where the government makes money. Apart from this, you have some kind of services being offered. So, in case of profit, it will not be just the profit from this, profit from the infrastructure investment also the toll highways.

So, after maintenance of the toll highways, if there is a National Highway Authority of India, it is managing and if it generates some excess money, then it will be also going into the government. So, all the PSUs public sector undertakings, so it also goes into that

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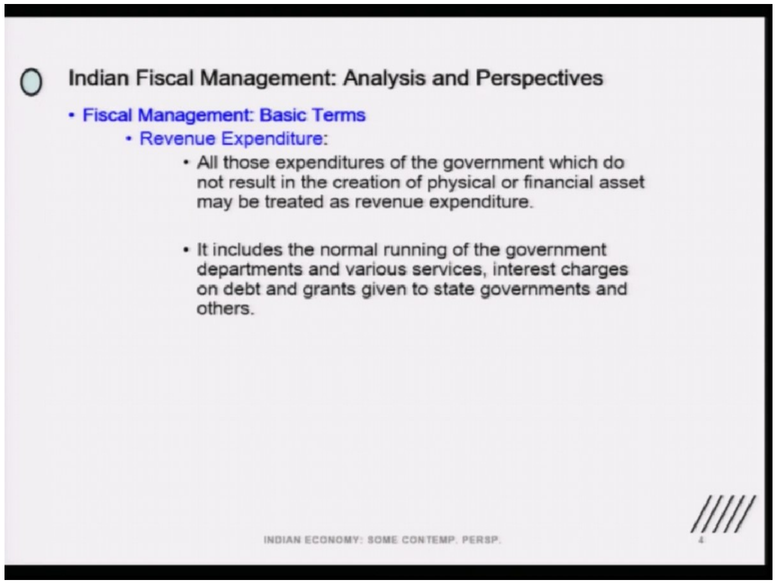

Then we have the revenue expenditure, all the expenditures of the government which do not result in the creation of the fiscal or financial asset, which means that it is just for the maintenance. So, for instance, if you are part of the university or any college system and the salaries of the teachers, faculty members all will come under the revenue expenditure, because it is just the maintenance or any kind of you have existing service which requires some kind of take and care then this will be, but there will not be any kind of new fiscal infrastructure coming.

So, if in your college, if you have a new classroom, new departments, new buildings coming up, so that will not be part of the revenue expenditure. So, mostly the personnel law and order maintenance personnel, so it means that police, army, so all these things will come under the revenue expenditure. So, all the expenditure of the government which do not result in the creation of fiscal or financial assets may be treated as the revenue expenditure. It includes the normal running of the government departments, various agencies and then, interest charges on debt and grants given to state governments and others.

So, basically it means that until and unless you have a new fiscal asset creation, then only you have a capital expenditure. You have two types of expenditure in India, which is called now we are discussing the revenue expenditure, but we also have the capital expenditure. In case of capital expenditure, this just goes against where it is the additional value addition or some kind of creation of the fiscal asset infrastructure, so that we call it the capital expenditure. In case of revenue expenditure, it is just the maintenance costs or the normal running of the government.

So, if you are going to hire a new teacher or any kind of if you are going to increase the seat in a course, for example, earlier the in a course the seats were only 40, but now government is going to increase it up to 30. So, those 20 increases will be not part of the revenue expenditure, it will be part of the capital expenditure, because for that the department and the school will receive extra fund.

So, once we have a simple office running kind of thing. So, that is why there is a special provision that how government can go for reducing the revenue expenditure up to 0 percent, so that there should not be any revenue expenditure, it will be only the capital expenditure. So, what happened in case of revenue expenditure is that, if your revenue expenditure is going to increase much, which means that you are not creating any kind of physical assets, but you are simply going for just for the sake of maintenance.

So, that becomes some kind of controversial topic because some argue that if the revenue expenditure is going to simply increase means that if you are going to increase the salary of your staff or you are just going to give them incentives, then that is not going to add that much value. It is better that you should invest in some new activities, where new activities will generate some extra income and that extra income may further generate revenue for your and your government.

So, in that regard, there are some disagreements among the economist, but the definition remains same that revenue expenditure, it is just the maintenance of or the running normal functioning of the government that you have or various agencies.

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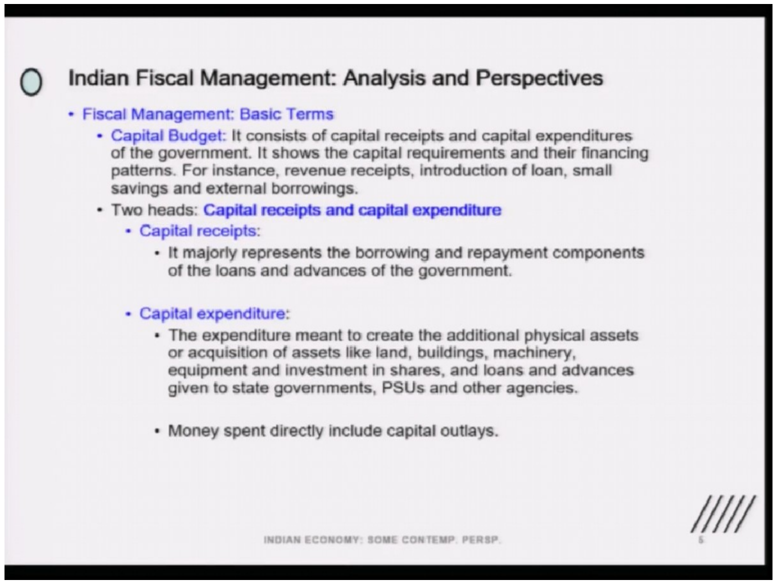

Then here, we have the capital budget. It consists of the capitalists of the capital expenditures of the government. It shows the capital requirement and their refinancing patterns. For instance, the revenue receipt, introduction of loan is small business houses, small savings, external borrowings, all those things. So, the capital receipts basically that it majorly represents the borrowing and repayment component of the loan and advances of the government which means that whatever it has received the capital.

So, for example, if you are going to set up a new institution or new university, then you need some amount of money. Suppose the government has gone for borrowing that amount. So, that will be a part of this. Plus, the repayment component, if there is already existing loan, there is some kind of loan service being made, then that will also be part of. And then, here, we have the capital expenditure. So, the expenditure means to create additional fiscal assets or acquisition of assets like land, buildings, machinery, equipment, investment in shares, loans and advances given to state government, PHOs and other agencies.

So, there is a, as I mentioned, in the case of revenue expenditure, we were just talking about the servicing part. Here, we are talking about the creation of the new or additional physical assets. So, in this, what typically happens that, in case a capital expenditure earlier it used to be a plan and non-plan expenditure. So, plan means that you are going to be having some kind of extra planning, which means that there will be additional fund allocation for that purpose. But non-plan it means that you are not going to get.

So now, it has been merged into the revenue and capital expenditure. Revenue expenditure takes care of the non-plan part and the plan part is taken care by the by the capital expenditure. So, capital expenditure is important to understand from the perspective that it talks about creating additional. So, once we have the additional asset, then it leads, so suppose in your university you are going to have a new auditorium or you are going to have new roads, so which means that there will be extra funds an allocation for that purpose they will be seeking out grant from different planning or different bodies. So, that will go into the capital expenditure.

And people have also agreed that the capital expenditure generates more income. But there is a limit to that, because, in case of developing countries, it is easier to say that the capital expenditure creates extra amount of employment and income. But in case of first world countries this goes completely against because they already have those infrastructures, so ultimately you have to spend either on the revenue side which means that the maintenance takes a lot of burden on the government. So, those things are added here.

There will be also a term called capital outlays. So, money which is being that directly spend that that comes under the capital outlay. So, I hope, the revenue and capital expenditure difference is now clear for all of you.

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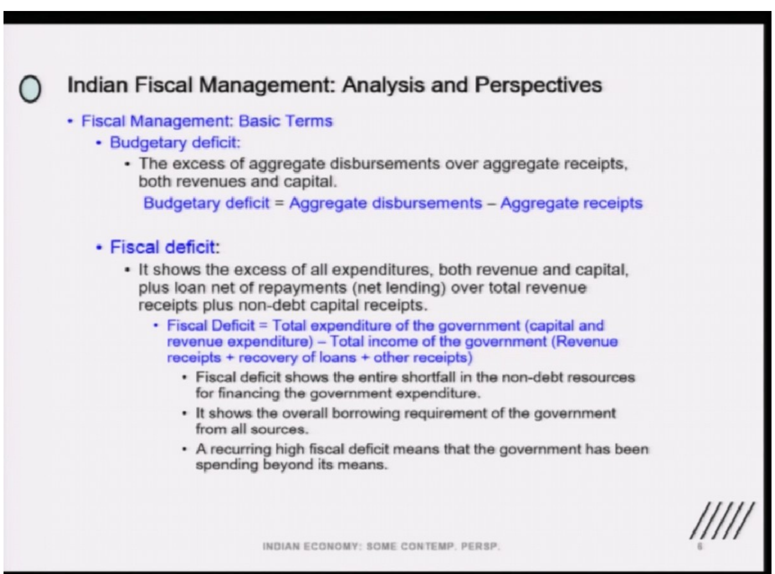

Then we have the budgetary deficits. So, budgetary deficit is nothing but whatever you have the expenditure aggregate, expenditure minus aggregate receipts that you have. One term that remains are quite debatable on your television channel and even in the print media, the indicator which gives a headache for everyone or it becomes a headache for everyone, which is the fiscal deficit.

It shows the excess of all expenditures both revenue and capital, plus loan net of repayment, net lending over the total revenue receipts plus the non-debt capital receipts. So non-debt capital simply that it is just some kind of extra grant or something. So, that will also be part of. So here, the proper definition includes the total expenditure of the government. Capital and revenue expenditure minus total income of the government revenue receipt plus recovery of the loans plus other assets.

So, in case of the deficit that we normally say about the budget deficit or the total deficit if you want so, gross revenue minus gross or you can simply calculate by taking to gross expenditure, whatever the revenue receipt that you have minus or you can simply go by the revenue expenditure minus the revenue receipt. So, that becomes the normal deficit that we have the gross deficit that we can say.

But in case of fiscal deficit, we also consider the net debt part so which means that it also talks about the loan net of payments. So, some kind of interest component will also be attached. And that is why this indicator shows also the borrowing side of the government. So, that is why the fiscal deficit becomes really important topic to talk about.

So, fiscal deficit shows the entire shortfall in the non-debt resources for financing the government expenditure. It shows the overall borrowing because as I told you, it also considers the net of repayment that how much it has been done over the total revenue. And it also shows that how much the government has gone or if the expenditure has increased so much, which means that this particular expenditure is going to be much higher.

So, for example, if you have the fiscal deficit of around 5 lakhs core and if the size of your GDP is around 2 lakh crores than it normally becomes the 2.5 percent. So, normally it is represented as percentage of GDP. So, it will be always been in the form of 2.5 percent of GDP, 5.5 percent of GDP. In the budget that has been announced recently and now, it is expected to go around 6, 6.8

percent which is the really worry. But keeping in mind the concerns of the pandemic and other it shows the realistic picture and going ahead the things will improve and then this fiscal deficit may come down again.

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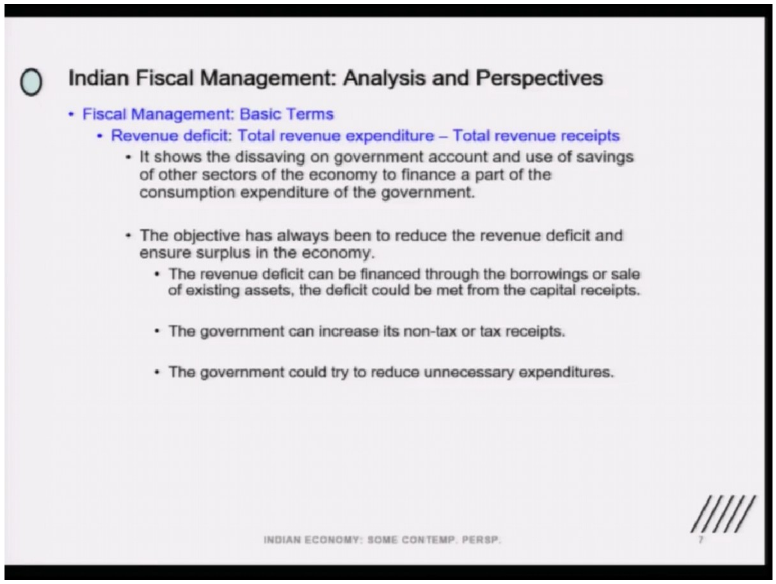

Then we have the revenue deficit, total revenues expenditure minus total revenue receipts that you have been borrowing is not considering and that is the difference that I wanted to mention in the previous. So, the revenue deficit shows the aggregate picture that this is what is going to be it saw that this saving on government account and the use of savings of other sectors of the economy to finance as part of the consumption expenditure. Because revenue expenditure it is nothing but it is not just from the tax side, but it is also from the non-tax side.

So, those things are also being added, which means that if some institutions are going to give their profit, which could have become their savings also so, that you are going to spend. The objective has also been to reduce the revenue deficit to ensure surplus in the economy. So, this is how it looks like. So, in this, the basic definition looks like this.

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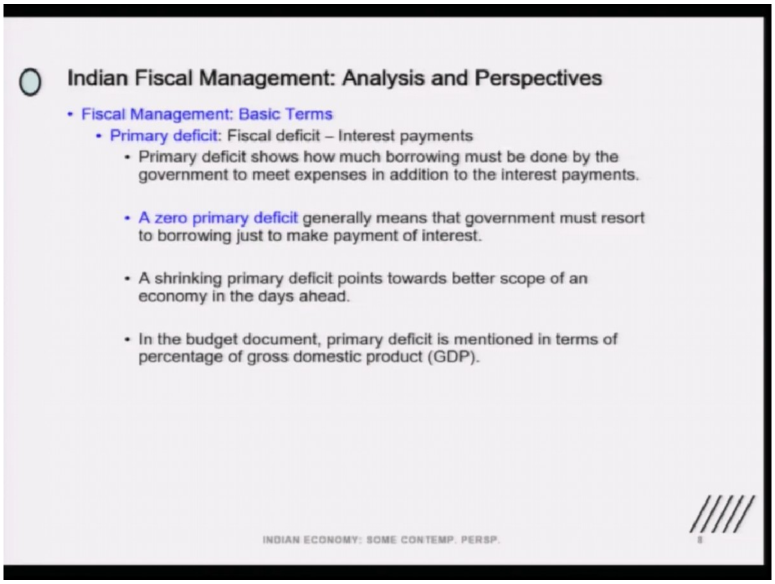

Then we have one more term which is very popular and is being mentioned always in the economic survey, which is the primary deficit and this is nothing but the fiscal deficit minus the interest payment. If interest payment is going to be simply 0, so 0 primary deficit, generally means that government is doing well and it is not required to or simply which means, that government is going to borrow from the and it is going to make some payment.

If the component of interest payment is lower, which means that the primary deficit is almost equivalent to the fiscal deficit, which also means that it is going to be better. Now, so, the interest component that you have the interest payment, if it is lower, it is always better that you are going to converge to the fiscal deficit. But if it is going to be higher than it is a concern. And it is also expressed as a percentage of GDP.

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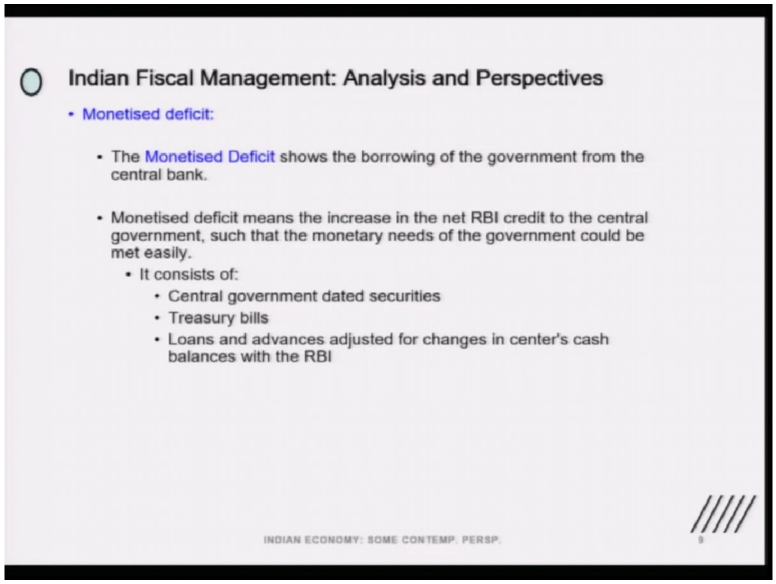

One more term that we always use in the area of public finance, it is called monetized deficit, which is also called the deficit financing. So, in case a monetized deficit, it happens that government borrows from the RBI. So, whenever they have the losses, I had also mentioned that we had gone for market stabilization scheme and in markets stabilization scheme, we had introduced some bonds but during 2008-09 crisis, government had gone for overtaking that. And that also became after some point of time part of the government expenditure.

So, the deficit financing is the easiest way to finance the deficit of the government. So, what typically happens is that whatever is the deficit being incurred by the government, government will simply ask the RBI to sanction the loan equivalent amount and it can. So, the RBI will simply lend to the government. So, monetize deficit means an increase in net RBI credit to the central government such that a monetary need of the government could merge easily. It consists of the central government data securities, treasury bills, loans and advances adjusted for center's cash balances with the RBI. So, all these things are part of the monetary deficit.

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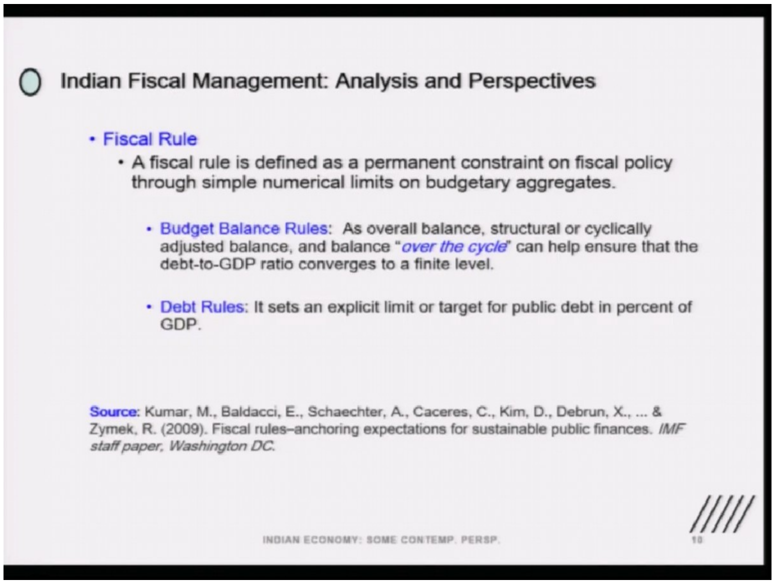

One more term that we should know as an as an economics and non-economics student that each and every country for the government you have been given some kind of yardstick to measure their performance. So, performance is being measured in India for the government that when things are all normal and government is able to stick to the fiscal rule that that we have defined through some acts.

So, in case of India, we have the fiscal deficit target, that should not go beyond 3 percent and if the government is able to maintain that which all other things keeping same, then that shows that the government is managing the expenditure side of the country quite efficiently. So, in this case, there are some concepts that one should know and in the case of several countries, you will find that, this rule is not the same for all. This rule varies according to the rules as specified by the country.

So, each and every country have different target. Some countries target the deficit, some countries target the debt, some countries target the budget. So, those for the sake of conceptual understanding, we should know about. So, there is a budget balance rules and overall balance is structural or cyclically adjusted balance and balance over the cycle can help ensure that debt to GDP ratio there is a budget balance. So, budget balance rule basically talks about the cyclical adjustment in the balance.

Balance in the sense that the one business cycle that you have or one economic cycle, so one year-on-year that you have and it targets about the debt to GDP ratio. So, the indicator under budget balance rule becomes your debt to GDP ratio. So, if the debt to GDP ratio is going to be higher than it means that government has to put a check. So, in case of most of the European countries, you will find that debt to GDP also becomes one of the important parameters. So, here in case of debt rule, also it becomes the same. It becomes the part of the data as a percentage of GDP.

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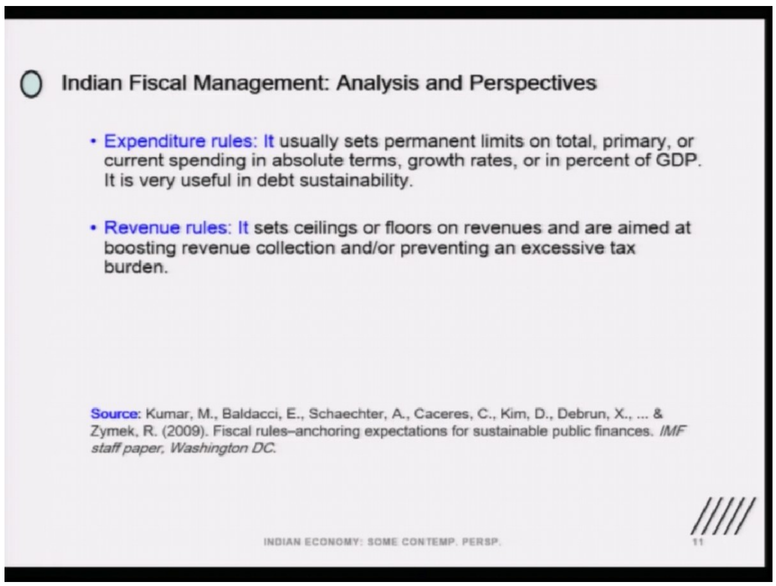

Then we have the expenditure rule. It usually sets permanent limits on total primary current spending in absolute terms growth or in percentage GDP. So, in our case, we have the expenditure rule. So, that is where we target the expenditure. Then we have the revenue rules, it sets ceilings or floors on revenues and are aimed at boosting revenue collection, preventing excessive tax burden, which means that a government is now targeting the revenue that if they have 100-billion-dollar rupee, then that is sufficient to manage the economy.

And for that, they cannot go for some kind of there is a rule to optimize the tax burden so that the, +it gives incentive to the taxpayer to pay otherwise, you should not keep the tax rate so high that it discourages the ambitions of the individuals. Because if the tax rate is going to be higher than it happens that people will be satisfied with the lower income job and they will not be aspiring to get into the higher income job because they know that if they are going to go into the higher income job, then the tax incidence is going to be higher and as a result they will have to pay, they have to sell out extra income and that may not be self satisfying for them from the effort point, that how much effort they have put and how much they are able to make money.

So, in each and every country, these rules are important. So, 3 indicators are important budget balance, which means that the revenue and deficit and then debt to GDP ratio, and then we have the revenue rules and the rules talks into account these about these things.

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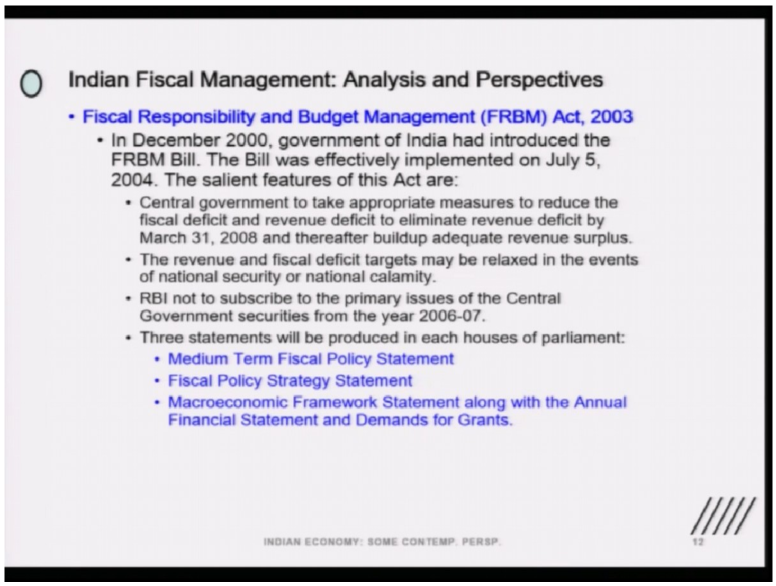

So, I just mentioned because now we are going to talk about the fiscal responsibility and budget Management Act 2003. And this act for the first time in December 2000 government had introduced this bill, but because it has a target on the specific indicators of the outlay or the expenditure, then the government at that time did not think about that much. But for the first time, some stringent rules were defined for the government that they have to go for check.

And this was also done partly because the Central Bank has a target of the inflation that they have to maintain or they have to have the stability in the price and based on that, they decide about the rate of interest. And based on that rate of interest, the banking system functions and every aspect of the monetary system is taken care.

But in case of fiscal space, when government comes into picture then government is having infinite space to play. So, sometime it is the disequilibrium created by the government which ultimately becomes the burden on the Central Bank to react and as a result, sometimes they it becomes the issue of the conflict of interest. And then ultimately, the cost of the damage is borne by the Central Bank not the government.

So, just to make sure that the fiscal side and monetary side, both (()) (25:55) both will think about going for any kind of extra expenditure or creating or going for or giving extra shock to the economic system. For the first time we had gone for FRBM Act 2003. So, it was mentioned to take appropriate measures to reduce fiscal deficit and revenue deficit to eliminate revenue deficit by March thirty first, 2008. And thereafter, build up adequate revenue surplus which means that this was also our check on the fiscal deficit and the revenue deficit, that we are going to have.

The fiscal, the revenue and the fiscal deficit target maybe relax. So, it was decided that you have the check, but if you have the unwanted events that you have, in that case, this target will not be met and government will be given some relaxation. RBI not to subscribe to the primary issue of the central government, so which means that you cannot go for the monetize deficit or the deficit financing every time from the year 2006-07.

3 statements will be produced in each houses of the Parliament. So, medium-term it is for 3 years, it will give the targets for these indicators. And then fiscal policy statement, it will also give you the idea about the disaggregated level, the indicators for these fiscal management and macroeconomic framework it will also provide the indicators for the macroeconomic management given these conditions.

So, for the first time, the Government of India had gone for such things to analyze and to understand that how these measures can help understand the economic system better. And then, the fiscal space can have a subtype adjustment, so that there will be some check and balance on the government also, so that they can also think about maintaining their budget.

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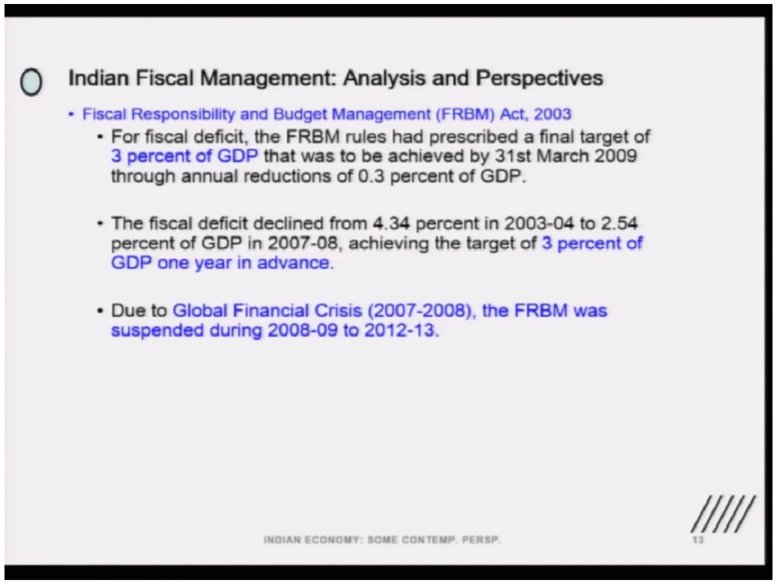

Then the rule had defined that the fiscal deficit will have the target rate of 3 percent of GDP that was to be achieved by thirty first, March 2009, though our annual reduction of 0.3 percent of GDP was accepted. The fiscal deficit for the first time declined 4.34 in the 2003-04 and 2.54 of the GDP in 2007-08 achieving the targeted rate of 3 percent of GDP one year in advance. So, this one was the target that we had then. But the FRBM Act when we had the global financial crisis at that time it was suspended.

So, if you want to get into more detail about this the N. K. Singh Committee report mentioned in detail about the FRBM-I then suspension and FRBM-II. So, just to conclude now, whatever we have covered, so we have covered the basics of the fiscal policy, some indicators which are important and we have also discussed the rules that we have framed. So, what are the rules that that are in the practice at the global level and where we can connect ourselves and then we are now discussing the FRBM Act. And going ahead, we will shed more light on this. So, I am going to stop here now. Thank you. Thank you so much.