M.Com. (Applied Economics)

Semester IV

Public Economics

Broad Topic

The measurement and determinants of fiscal deficits

Part - I

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Introduction and background

The government intervenes in the economy through two main instruments – monetary policy and fiscal policy. Fiscal policy which is the focus of the current discussion is defined as "the policy which guides the allocation of funds and the act of raising adequate funds for the purpose" (Vaishamapayan 2011, p. 545). Thus, fiscal policy mainly involves expenditure policy (where to spend, how much to spend), taxation policy (what should be the tax structure) and debt policy.

In every nation of the world the governments undertake several functions. Their range of activity differs depending upon the type of government like capitalist system, socialist system or communist system. Some essential functions are performed by all the governments. For instance, defence, local policing, civil administration, regulatory mechanism and provision of some essential services like health, education, power, infrastructure, etc. However, government needs to perform these functions. The functions of the government can by summarized in the following three categories:

1. Allocation
2. Redistribution
3. Stabilisation

Allocation function mainly comprises all those policy decisions of the government which affect the provision of goods and service being produced in an economy. The redistribution function assumes that inequalities should be at the minimum level therefore, the government has the responsibility to redistribute of income and wealth in favour of poor people. Taxation of rich and transfer payments to poor is the way through which redistribution can be insured. The stabilization function of the government includes stability of prices, full employment, stability of the overall economy, external balance and rapid economic growth.

However, government needs funds to perform these functions. Unlike individual's budget where an individual decides his/her expenditure after looking at the income, the government does the reverse. It decides first its expenditure responsibility then it decides how to arrange for this expenditure through tax and non-tax revenues. In the case of developing countries which suffer from low income levels, high incidence of poverty and unemployment, low degrees of urbanisation and industrialisation, the revenue often falls short of its expenditure needs. This creates deficit which is a normal case for the governments. The RBI terms the gap between revenue and expenditure is as resource gap. The financing of this gap is called as monetization of budgetary deficit. As per Vaishampayan (2011, 560), "the definition of deficit financing adopted in India has been somewhat different from what it was taken in the developed countries. While in the developed countries budget deficit meant, different between revenue receipt and total expenditure which was mostly financed by public debt and sometimes by monetisation (issuing of new currency) also. In India since 1950-51, the government of India recognized only two types of deficits – Revenue deficit and overall budgetary deficit".

Where

Revenue deficit = Revenue expenditure – Revenue receipts

Overall budgetary deficit = Total expenditure – Total receipts = (Revenue receipts + capital receipts) – (revenue expenditure + capital expenditure)

Deficit Indicators

As per the RBI publications, the definitions of various deficit indicators are as follows:

Revenue Deficit denotes the difference between revenue receipts and revenue expenditure.

The conventional deficit (budgetary deficit) is the difference between all receipts and expenditure, both revenue and capital.

The gross fiscal deficit (GFD) is the excess of total expenditure including loans net of recovery over revenue receipts (including external grants) and non-debt capital receipts. Since 1999-2000, GFD excludes States' share in small savings as per the new system of accounting.

The *net fiscal deficit* is the gross fiscal deficit less net lending of the Central Government.

The *net primary deficit* denotes net fiscal deficit minus net interest payments. Primary revenue balance denotes revenue deficit minus interest payments.

The *net RBI credit to the Central Government* represents the sum of variations in the RBI's holdings of (i) Central Government dated securities, (ii) Treasury Bills, (iii) Rupee Coins and (iv) Loans and Advances from RBI to Centre since April 1, 1997 adjusted for changes in the Centre's cash balances with RBI in the case of Centre. Regarding State Governments, net RBI credit refers to variation in loans and advances given to them by the RBI net of their incremental deposits with the RBI, for the State Governments having accounts with the RBI.

Measures of Resource Gap: Concepts and Definitions

The different measures of deficit (resource gap) are given below.

(a) Revenue Deficit (RD) denotes the difference between revenue receipts and revenue expenditure.

Revenue Account Gap = Revenue Deficit (RD) = Revenue Receipts (RR) – Revenue Expenditure (RE)

(b) Capital Deficit denotes the difference between capital receipts and capital disbursements.

Capital Account Gap = Capital Account Deficit (CAD) = Capital Receipts (CR) – Capital Disbursements (CD)

(c) Conventional deficit (budgetary deficit or overall deficit) is the difference between all receipts and expenditure, both revenue and capital.

Overall Gap = RD+CAD = (RR-RE) + (CRCD) = [(RR+CR) – (RE+CD)]

(d) Gross Fiscal Deficit (GFD) is the difference between aggregate disbursements net of debt repayments and recovery of loans and revenue receipts and non-debt capital receipts.

Gross Fiscal Deficit (GFD) = RE + [CD-(Discharge of Internal Debt (DID) + Repayment of Loans to Centre (RLC) + Recoveries of Loans & Advances (RLA)] – RR

= RE + [Capital Outlay (CO) + Loans & Advances by States (LAS) + DID+RLC – (DID +RLC+RLA)] –RR = (RE-RR) + [CO+ (LAS-RLA) + (DID-DID) + (RLC-RLC)]

= RD+CO+ Net Lending (NL)

(e) Net Fiscal Deficit (NFD) is the gross fiscal deficit *less* net lending of the State Governments.

Net Fiscal Deficit (NFD) = GFD – (LAS-RLA)

(f) Gross Primary Deficit (GPD) is defined as GFD *minus* interest payments.

Primary Deficit (PD) = GFD – Interest Payment (IP)

(g) Net Primary Deficit (NPD) denotes net fiscal deficit (NFD) *minus* net interest payments.

Net Primary Deficit (NPD) = NFD – [(IP Interest Receipts (IR)]

(h) Primary revenue balance denotes revenue deficit *minus* interest payments.

Primary Revenue Balance (PRB) = RD – IP

(i) Net primary revenue balance denotes revenue deficit *minus* net interest payments.

Net Primary Revenue Balance (NPRB) = RD – (IP-IR)

Just for the sake of understanding following is the summary of States' Budget

Table II.6: Variation in Major Items

(₹ billion)

Item	2014-15	2015-16	2016-17	2017-18 (RE)	2018-19 (BE)	Percent Variation	
						2017-18 RE over 2016-17	2018-19 BE over 2017-18 RE
1	2	3	4	5	6	7	8
I. Revenue Receipts (i+ii)	**15,915.8**	**18,328.8**	**20,464.0**	**24,577.2**	**28,129.9**	**20.1**	**14.5**
(i) Tax Revenue (a+b)	11,171.1	13,533.4	15,207.7	17,437.7	20,134.5	14.7	15.5
(a) Own Tax Revenue	7,792.8	8,471.4	9,129.1	10,503.5	11,988.0	15.1	14.1
of which: Sales Tax	4,942.7	5,282.4	5,874.5	4,309.7	3,085.6	-26.6	-28.4
(b) Share in Central Taxes	3,378.4	5,061.9	6,078.6	6,934.2	8,146.6	14.1	17.5
(ii) Non-Tax Revenue	4,744.7	4,795.5	5,256.3	7,139.5	7,995.4	35.8	12.0
(a) States' Own Non-Tax Revenue	1,436.7	1,536.5	1,695.4	1,945.9	2,249.0	14.8	15.6
(b) Grants from Centre	3,308.0	3,259.0	3,560.9	5,193.6	5,746.4	45.8	10.6
II. Revenue Expenditure	**16,372.9**	**18,382.7**	**20,868.9**	**25,188.0**	**27,837.8**	**20.7**	**10.5**
of which:							
(i) Development Expenditure	10,403.9	11,811.4	13,404.6	16,122.9	17,508.1	20.3	8.6
of which: Education, Sports, Art and Culture	3,154.3	3,494.9	3,869.3	4,312.5	4,979.2	11.5	15.5
Transport and Communication	430.5	409.7	451.4	471.7	482.2	4.5	2.2
Power	922.8	1,089.1	1,300.5	1,206.2	1,254.3	-7.3	4.0
Relief on account of Natural Calamities	180.6	327.4	280.0	299.3	210.5	6.9	-29.7
Rural Development	952.2	1,079.7	1,262.5	1,488.0	1,624.8	17.9	9.2
(ii) Non-Development Expenditure	5,505.1	6,086.1	6,910.1	8,351.8	9,506.3	20.9	13.8
of which: Administrative Services	1,199.5	1,302.1	1,455.8	1,765.1	2,075.4	21.2	17.6
Pension	1,830.7	2,041.4	2,261.4	2,789.4	3,104.0	23.4	11.3
Interest Payments	1,904.2	2,142.5	2,513.0	2,927.5	3,154.6	16.5	7.8
III. Net Capital Receipts #	**3,439.4**	**4,246.3**	**5,603.8**	**5,221.1**	**5,324.3**	**-6.8**	**2.0**
of which: Non-Debt Capital Receipts	200.6	83.1	162.1	564.8	597.1	248.3	5.7
IV. Capital Expenditure $	**3,015.5**	**4,236.0**	**5,100.5**	**5,097.1**	**5,754.4**	**-0.1**	**12.9**
of which: Capital Outlay	2,719.1	3,333.8	3,921.9	4,707.1	5,377.9	20.0	14.3
of which: Capital Outlay on Irrigation and Flood Control	555.8	685.2	832.6	945.8	1,118.2	13.6	18.2
Capital Outlay on Energy	338.7	466.3	531.3	489.0	455.6	-8.0	-6.8
Capital Outlay on Transport	663.1	788.5	948.0	1,079.9	1,111.1	13.9	2.9
Memo Item:							
Revenue Deficit	457.0	53.8	404.9	610.8	-292.2	50.8	-147.8
Gross Fiscal Deficit	3,271.9	4,206.7	5,343.3	5,143.2	4,865.1	-3.7	-5.4
Primary Deficit	1,367.8	2,064.2	2,830.3	2,215.7	1,710.6	-21.7	-22.8

RE: Revised Estimates. BE: Budget Estimates.

: It includes following items on net basis Internal Debt, Loans and Advances from the Centre, Inter-State Settlement, Contingency Fund, Small Savings, Provident Funds, Reserve Funds, Deposits and Advances, Suspense and Miscellaneous, Appropriation to Contingency Fund and Remittances.

$: Capital Expenditure includes Capital Outlay and Loans and Advances by State Governments.

Note: 1. Negative (-) sign in deficit indicators indicates surplus.

2. Also see Notes to Appendices.

Source: Budget documents of state governments.