Fiscal Deficit: Current scenario in India

Fiscal deficit is one of the most discussed topics during the last few months especially after so much importance being given to it in the budget and concerns being raised over increasing deficit in proportion with GDP.

Fiscal Deficit: Meaning

Fiscal deficit is an economic phenomenon, where the Government's total expenditure surpasses the revenue generated. It is the difference between the government's total receipts (excluding borrowing) and total expenditure. Fiscal deficit gives the signal to the government about the total borrowing requirements from all sources.

Fiscal deficit tends to increase inflation in the country as the difference in income and expenditure is financed by borrowing from RBI which tends to increase money supply in the economy hence depreciating value of money and increasing inflation in the country.

Fiscal deficit suggests expenditure of government is more than its revenue. It becomes very important that the expenditure is in the areas that will generate income in future. Therefore proper allocation and monitoring of expenditure is one of the most important activities to ensure long term growth of the country.
Fiscal deficit has always been a concern for India as it is a developing country and most of the developing countries have to make a tradeoff between GDP growth and fiscal balance. Since the expenditure of government is more than revenue generated and reducing expenditure may slow down the growth of economy therefore deficit cannot be totally eliminated.

Financial Crisis of 2008: Impact and response:

The focus of world shifted on fiscal deficit after there was turmoil in European market after the world witnessed the biggest crisis since the great depression of 1931. A number of European countries are on a verge of bankruptcy and had it not been for timely interference of European Central Bank the very existence of EURO as a centralized currency for Europe was in danger. The European market has still not recovered from it and Greece, Ireland and Portugal have been bailed out by ECB to save them from bankruptcy. We are not sure what would be the impact on Euro if some of the countries are removed from Euro zone. Considering the reluctance of bigger economies of Euro zone and their own weak financials the future of Euro as a currency is still uncertain.

The Reserve Bank of India in its response to the 2008 crisis and in its efforts to protect the Indian economy announced several stimulus packages for various Industries. The repo rate was reduced from 9% in December 2008 to as low as 4.75% in May 2009 encouraging companies and individuals to spend more.

RBI policy helped the country to recover from the crisis quickly however it also resulted in increasing the inflation rate. Inflation rate was 5.5% before the crisis in March 2008 and it increased to alarming rate of 16% in February 2010. Despite the fact that RBI has increased repo rate to 8.5% since April 2010 when it was 3.25% to curb inflation, the impact on inflation is not as per expectations. The inflation remained at 9.11 % in November 2011 well above the RBI comfort level of around 5%. We have already witnessed the impact of raising rate, inflation and fiscal deficit on the performance of Indian companies. Many of the companies are trading at values lower than 2008 levels.

India's Fiscal Deficit: Current Scenario

India has one of the largest fiscal deficits in the world. The fiscal deficit of F.Y. 2010-11 is expected to be 5.10% of GDP which is expected to be reduced to 4.6% in F.Y. 2011-12 and further to 4.1% in F.Y. 2012-13. The decrease in fiscal deficit in f.y. 2010-11 was due to inflow to the tune of 67,000 Crores from 3 G auctions against planned inflow of 35,000 crores.

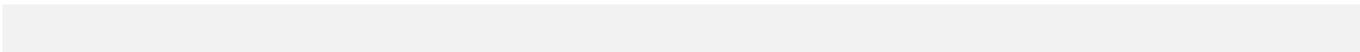
The government has planned to raise Rs.40,000 Crores from disinvestment in the current financial year. However considering government track record in timely completion of its disinvestment plans (Rs.22,144 Crores were raised in f.y. 2010-11 against planned Rs. 40,000 Crores) raising such funds will not be possible in the current year. We are going to miss the targeted fiscal deficit quite comprehensively in the current year. The deficit of April-November 2011 has already been more then 85% of whole year target. It is quite possible that the fiscal deficit of current year is more than 5.1% of GDP against the target of 4.6% of GDP.

Subsidies provided by the government constitute major element of government expenditure. However major portion of it does not reach the persons for whom it is intended. One of the proposals of the government committee on reforming the public distribution system is to directly transferring the funds to the accounts of poor can provide breakthrough results if properly implemented. It will have indirect impact of extending the benefits of banking system to the remote areas of the country by cultivating the habit of using banking channel for transactions among general public. It will ensure that bottlenecks are removed and the benefits reach the person for whom it is intended.

Conclusion:

I would like to conclude that a balance between growth and deficit is necessary and the government should try to ensure that the pace of growth is maintained and fiscal deficit should remain at reasonable levels. Balance of payment position can be improved if the quality of funds flowing in the country is good. India require more investments through FDI which is a long term and stable source of funds rather than FII also known as hot money which is short term in nature and its sudden withdrawal can cause severe impact on balance of payment and fiscal deficit.

Moreover lack of control on spending by the government has made RBI hapless and RBI is unable to control inflation despite tight monetary policy and compromising the growth of Indian companies. It would be interesting to



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