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Why pursue a zero revenue deficit goal?

FISCAL MATTERS. A single minded pursuit of this target, accompanied by a mindless transition to capex, can hurt the poor

GIRI KVS

In the post pandemic fiscal strategy, the "golden rule" of targeting zero revenue deficit is gaining attention as a powerful mantra of fiscal discipline. The "golden rule" translates that the revenue receipts should be the basis of revenue expenditure design and the entire borrowings will go for financing capital spending.

In the times of war and crisis, going back to a strict golden rule is not feasible as it affects human capital formation and the economic growth process. A clarion call for zero revenue deficit is welcome only if it is attempted through tax revenue buoyancy than revenue expenditure compression.

If the zero revenue deficit is attained through compression in revenue spending related job guarantee schemes, cuts in education and health spending, and social security measures, it can trigger a humanitarian crisis amidst widening inequalities in the post pandemic period.

When revenues are increasingly uncertain, the fiscal consolidation path towards zero revenue deficit might occur through revenue expenditure compression. Volatility in inter-governmental fiscal transfers from the Centre to States further affects the latter's fiscal space. The recent announcement that contingent liabilities will be considered within the net borrowing ceiling limit has also affected the fiscal space of the States.

In cooperative federalism, fiscal rules have been tied to energy transition; both will move together against COP27 commitments. For instance, the structural reforms in power sector are closely linked to medium term fiscal consolidation strategy — States can avail themselves of extra borrowing powers of 0.5 per cent within the 3.5 per cent fiscal deficit to GDP ratio.

THE CLASSIFICATIONS

In the classification of budgetary transactions, revenue expenditure is further re-categorised into general services, economic services and social services. A step further is to say general services (mainly interest payments, salary and pensions, establishment expenses) are non-developmental spending. Social services (mainly social infrastructure spending including education, health, water and sanitation) and economic services are broadly classified as developmental spending.

What is crucial here is measurement of "fiscal risks". Running high ratio of interest payments to revenue receipts can affect fiscal sustainability. Will the 16th Finance Commission articulate about the fiscal risk ratio thresholds instead of an overall fiscal rule of zero revenue deficit? If so, what will be the revised threshold ratios for interest payments to revenue receipts? Will there be an articulation about a threshold ratio for pension to revenue receipts given the increasing recognition of a few governments in reviving the old pension scheme? What could be the operational parameter of fiscal stance — fiscal deficit, revenue deficit or primary deficit?

When we try to answer these questions, it is interesting to recall the dissent note by Arvind Subramanian in the FRBM committee report about the significance of making the primary deficit the operational parameter of fiscal stance. Primary deficit is about the fiscal deficit devoid of past interest payment liabilities. As interest rate is exogenous to the Finance Ministry, can a focus on primary deficit increase the attention of the Finance Minister to the "discretionary fiscal space" available before him/her for expenditure design?

Yet another crucial question concerns ideal budgetary classifications. The sanctity of disaggregating budgetary transactions into revenue and capital, Plan and non-Plan, development and non-development is being increasingly questioned. India has done away with Plan and non-Plan distinction in budgetary transactions with the phasing out the Planning era. The revenue and capital distinction becomes concerning as some revenue expenditures are capital creating in nature. This needs to be recognised in view of pursuing a phase-out of the entire revenue deficit. "Effective revenue deficit" is calculated to address this concern.

The ideal concept of deficit which measures the real macroeconomic gap is Public Sector Borrowing Requirement (PSBR) and not the fiscal deficit or revenue deficit

A mindless transition to capex, ignoring revenue expenditure, can be detrimental. This transition might occur on the assumption that capex in infrastructure crowds in private corporate investment and can trigger growth, though with a lag.

EFFICIENCY FACTOR

When we talk about social infrastructure, especially in health and education, an important concern is whether the money is well spent. Efficiency of public expenditure is crucial as it is linked to Budget credibility. Significant deviations between what is budgeted (Budget Estimates) and Actuals — which is technically referred to as "fiscal marksmanship" — can erode budget credibility. However, fiscal accountability exercises and expenditure tracking studies point to implementation issues in the social sector spending; a course correction is important in linking resources to results.

However, these inferences should not be used to decrease allocation to these merit goods, as its positive externalities benefit those in the lower income quintiles. The public expenditure benefit incidence analysis (which gives the distributional justice of public spending) reveals that lower income quintiles access public education and public health in India.

Dealing with a plethora of matrices and deficit measurements — revenue deficit, fiscal deficit, primary deficit — began with the first IMF survey to move away from "single concept of deficit" to "purpose specific deficits". However, the ideal concept of deficit which measures the real macroeconomic gap is Public Sector Borrowing Requirement (PSBR) and not the fiscal deficit or revenue deficit.

PSBR measures the resource gap of "general government" (all tiers of government) plus public sector deficits. Data constraints thwart the time series construction of PSBR. The time series data on "general government" across countries are provided by the IMF Government Finance Statistics (GFS) database.

However, there are severe lags in GFS data on India. GFS classifies expenditure as "functional" (for instance, sectoral like education, health, defence etc) and "economic" (how much for salary and wages, capital formation etc). Plan and non-Plan; and development and non-development constructs are India-specific.

Rethinking of fiscal rules — especially going for zero revenue deficit — should be placed within the complex frameworks of Indian public finance.

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