

● FISCAL DEFICIT OR DEBT-GDP RATIO

WE NEED TO TRANSLATE PREFERRED PATH OF DEBT-GDP RATIO INTO IMPLIED PATH OF FISCAL DEFICIT

Focus of fiscal health

CONTAINING FISCAL DEFICIT was one of the elements of fiscal reforms initiated in the early 1990s. Fiscal imbalances had started deteriorating in the late 1970s for both central and state governments. The central account went into consistent revenue deficit from 1979-80 onwards. On the aggregate account of states, revenue deficit started appearing on a consistent basis from 1987-88 onwards. Fiscal deficit for the Centre relative to GDP averaged 5% in the 1990s. An attempt was made to reduce the monetisation of fiscal deficit in the '90s. The system of issuing ad hoc treasury bills was discontinued in April 1997. The Centre's fiscal deficit increased to an average of 5.2% of GDP in the first five years of the 2000s. In order to check the inordinate increase in its fiscal deficit relative to GDP, a Fiscal Responsibility and Budget Management Act (FRBMA) was enacted in 2003. This Act provided for achieving balance on the revenue account and limiting fiscal deficit to 3% of GDP.

In terms of budgeted fiscal deficit, a level of 3% of GDP was achieved only once in 2007-08. Thus, the Act was observed more in breach than in observance. In its 2018 amendment, the target of achieving balance on revenue account was given up altogether. The Act said: "The Central Government shall — (a) take appropriate measures to limit the fiscal deficit up to three per cent of gross domestic product by the 31st March, 2021." It also said that the Centre shall "endeavour to ensure that — (i) the general Government debt does not exceed sixty per cent; (ii) the Central Government debt does not exceed forty per cent of gross domestic product by the end of financial year 2024-2025." Thus, the Act continued to emphasise fiscal deficit relative to GDP while adding additional targets with respect to debt-GDP ratios of the general government and for the Cen-

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tre. In the meantime, states too passed suitable legislation limiting the fiscal deficit at 3% of state domestic product. The general government debt-GDP ratio shot up to close to 90% in the Covid year and the Centre's debt-GDP ratio went up to nearly 60%. The FY26 Budget contended that we should follow a different path. It has been stated that from now on, the focus will be on annually reducing the debt-GDP ratio. In the annexure statement, alternative paths of the debt-GDP ratio with nominal GDP growth assumptions of 10.0%, 10.5%, and 11.0% are given. The glide paths are indicated with alternative assumptions on mild, moderate, and high degrees of fiscal consolidation. This makes the effort towards fiscal consolidation quite vague. The document outlines a declining path of debt-GDP ratio reaching a level of $50 \pm 1\%$ of GDP by 2030-31. It can be shown that if the nominal GDP growth is 10.5%, a fiscal deficit of 3.8% of GDP maintained year after year from 2026-27 onwards will bring the debt-GDP ratio down to 50% by the end of 2030-31. This is consistent with a moderate degree of fiscal consolidation. This path will imply a higher level of fiscal deficit than 3% of GDP, which should be a matter of concern. There is no indication whether the FRBMA-2018 target of 40% of debt-GDP ratio has been given up alto-

gether. Assuming a nominal GDP growth of 10.5%, a declining path of fiscal deficit to GDP ratio to attain a level of 3.2% by 2028-29 and subsequently maintaining fiscal deficit at 3% of GDP would enable reaching the FRBM debt-GDP target by 2037-38.

Fiscal deficit and saving-investment balances

The Twelfth Finance Commission

had argued that the investible surplus for the private corporate sector and the non-government public sector can be derived as the excess of household financial savings and net inflow of foreign capital over the draft of this surplus by the central and state governments through their borrowing.

The recent tendency is for the household financial savings to come down. According to Reserve Bank of India data, in 2022-23 and 2023-24, it was 5.0% and 5.3% of nominal GDP as against an average of 7.6% during 2017-18 to 2021-22 excluding the Covid year of 2020-21. With 5% of household savings and about 2% of net inflow of foreign capital, available investible surplus of 7% will be fully pre-empted by the fiscal deficits of central and state governments at about 7.4% of GDP. The non-government public sector and private corporate sector will have to borrow from abroad, increasing the net inflow

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of foreign capital well above sustainable levels. There is thus strong logic behind maintaining the fiscal deficit of the Centre and states taken together at 6% of GDP and we should follow a path of fiscal consolidation which is consistent with this.

Interest payments and revenue receipts

In India's context, if the debt-GDP ratio remains relatively high compared to the norms given in the Centre and states' fiscal responsibility legislations, the ratio of interest payment to revenue receipts would also remain high, pre-empting government's revenue receipts while leaving progressively lower shares for financing non interest expenditures. The ratio of the Centre's interest payment to revenue receipts net of tax devolution, which had fallen to 35% in 2016-17, has increased to an average of 38.4% during 2021-22 to 2023-24. This ratio has fallen to 36.9% in the revised estimates for 2024-25 but is budgeted to increase again to 37.3% in 2025-26.

There are many countries which have a far higher level of government debt-GDP ratio as compared to India. Their interest payments to revenue receipts ratio, however, is much lower. For example, during 2015 to 2019, the ratio of interest payment to revenue receipts averaged only 5.5%, 6.6%, and 8.5% for Japan, the UK and the US. This is because their revenue receipts relative to GDP are much higher.

As it stands now, the goal is unclear. Since the operating variable is fiscal deficit, we need to translate the preferred path of debt-GDP ratio into the implied path of fiscal deficit. We can then find out whether that fiscal deficit is appropriate or not. In fact, a larger claim on the available investible resources by the government will make it difficult for the private investment to pick up.

Views are personal