NOTE

QUALITY OF FISCAL DEFICIT

Bharat Jhunjhunwala writes :

Finance Minister Pranab Mukherjee has relied on in-crease in fiscal deficit to break the recession. The fiscal deficit was about 3 percent of the national income two years ago. It increased to 6.2 percent in the last year, 2008-09. Now Mr Mukherjee has proposed to increase it to 6.8 percent for the coming year.

Expenditures in excess of income of the government are called fiscal deficit. The government has the authority to print notes or borrow from the public or foreign countries in any quantity and incur expenditures greater than its revenues. Such increase in expenditures leads to price rise. In reality fiscal deficit transfers purchasing power from public to the government.

Private expenditures are generally considered better than government expenditures because the latter has a huge problem of leakages. Say, for example, the government prints notes worth Rs 50 and the Minister deposits the money in a Swiss bank. Now the Swiss Bank will lend the money to some buyer who will buy goods from India and take it to Europe. This would be highly harmful for Indian economy. Thus, it is considered good to keep fiscal deficit in check.

A different policy is suitable under conditions of recession, however. Say, the public is afraid of an impending recession and is unwilling to buy goods from the market. It is more inclined to save its incomes for possible bad times in future. In such situation, goods may lie unsold in the market because people are unwilling to spend. This leads to recession. In such circumstances it is acceptable to increase government expenditures much like a patient is given tonic to jumpstart his digestive system. The increase in demand from the government starts a cycle of consumption, purchase and production. In the light of above discussion, fiscal deficit is justified if the quality of government expenditures is good and if this is resorted to for a short period in exceptional circumstances.

The budget presented by Mr Mukherjee does not fare very well on the touchstone of quality. Government expenditures can be classified in four categories. The lowest category is that of government consumption. Bigger pay packages given to government employees under the Sixth Pay Commission are of this type. Consumption needs of government employees are mostly already fulfilled. They will mostly buy gold from the additional incomes and this money will find its way to South Africa. The impact on the domestic economy will be like that of sedatives. Second category of expenditures is that towards NREGA and food subsidies. These are of medium quality. The poor mostly spend the Rs 100 wage received by them from NREGA. Consumption by the poor increases as a result. A fortuitous cycle of increased consumption, demand and production is initiated.

Third category of expenditures is investment in capital-intensive infrastructures such as highways. These too are of medium quality. Such expenditures lead to higher demand for steel and cement. Also the highway acts as a lubricant for the economy. But these are not so beneficial for the common man. Fourth category of expenditures is investment in labour-intensive infrastructure. The government can give labour vouchers to departments like PWD, irrigation, forest and highways. This will lead to a spontaneous increase in the budget of these departments. It will become attractive for them to use labour to dig foundations instead of employing excavators because labour vouchers are available for free. This policy is the best. This will be pro-people, it will generate a cycle of consumption, demand and production, and it will provide lubricant to the economy in the infrastructure that is made.

Mr Mukherjee has increased expenditures in the lower three categories. More money is provided to government employees under the Sixth Pay Commission. More money is allocated to NREGA and also capital-intensive infrastructure. But there is absence of expenditures on labour-intensive infrastructure.

Former Economic Advisor Shankar Acharya writes: "The bulk of the massive expenditure increase is due to interest payments, defense, subsidies, salaries and pensions, and major social programmes such as NREGA and Bharat Nirman. The notion of a temporary fiscal stimulus assumes that it can be readily reversed when the need for the stimulus goes. None of the expenditure categories mentioned above looks very reversible to me." This writer agrees. The quality of expenditures in-built into the fiscal deficit is poor. □□□