Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: about the govt’s move to cut expenditure and its implications on the economy; about fiscal deficit

News: The government is likely to cut spending for the current fiscal by as much as Rs.2 trillion (Rs. 2 lakh crore) as it faces one of the biggest tax shortfalls in recent years.

Background

Economic growth slowed for six consecutive quarters to 4.5% in July-September, despite a 135 basis point cut in interest rates by the Reserve Bank of India (RBI) since February 2019.

Likely implications of the move

- Asia’s third largest economy, which is growing at its slowest pace in over six years because of lack of private investment, could be hurt further if the government cuts spending.

- But with a revenue shortfall of about Rs. 2.5 trillion, the government has little choice to keep its deficit within “acceptable limits”.

- The Centre has spent about 65% of the total expenditure target of Rs. 27.86 trillion till November but reduced the pace of spending in October and November, according to government data.

- A Rs. 2 trillion reduction would be about a 7% cut in total spending planned for the year. In October and November, government spending increased by Rs. 1.6 trillion, nearly half the Rs. 3.1 trillion it spent in September. Lack of demand and weak corporate earnings growth in the economy led to lagging tax collections this year. Analysts said growth will be hurt.
Now, even the RBI seems to have become more worried about inflation rising. It kept its key lending rate on hold on December 5, though it slashed its growth forecast for the current fiscal to 5%, which would be the lowest in a decade. Even a surprise corporate tax rate cut announced by Finance Minister Nirmala Sitharaman earlier this year failed to spur private investment in the economy.

Way ahead

The Centre is likely to keep fiscal deficit under 3.8% of GDP. It is likely to announce additional borrowing of Rs.300500 billion for the current year to match the revised fiscal deficit.

About fiscal deficit

- The fiscal deficit is the difference between the government’s total expenditure and its total receipts (excluding borrowing).
- Fiscal deficit in layman’s terms corresponds to the borrowings and liabilities of the government.
- As per the technical definition, Fiscal Deficit = Budgetary Deficit + Borrowings and Other Liabilities of the government.

Note:

1. Deficit differs from debt, which is an accumulation of yearly deficits. The elements of the fiscal deficit are revenue deficit and capital expenditure.
2. Revenue deficit is the difference between the government’s revenue expenditure and total revenue receipts.