Fiscal Deficit

[UPSC Notes]

What is Fiscal Deficit?

The difference between the total government expenditure and its total receipts, excluding the borrowing, is known as Fiscal Deficit. One should note that here, the term deficit doesn't mean debt.

Due to the events like a major rise in capital expenditure and deficit arising from the revenue, a Fiscal Deficit occurs. It plays a significant role in knowing how the government is managing its finances.

Formula for Calculating Fiscal Deficit

By marking out the difference between the total income and the total expenditure by the government, the Fiscal Deficit is calculated.

To calculate the Fiscal Deficit, all taxes, non-debt capital receipts, and other ways of revenue except borrowing are included in calculating the total income of the government.

Fiscal Deficit = (Revenue Expenditure + Capital Expenditure) – (Revenue Receipts + Capital Receipts).
The formula reads out in the simplified form as-.
Fiscal Deficit = Total expenditure — Total receipts excluding borrowings.
In most economies, the expenditure by the government is more than its income around the world, including in India means they run under a Fiscal Deficit.

Components of Fiscal Deficit

Fiscal Deficit has been calculated On the basis of two-components:

Revenue Component

- Both lead to the income component, either the revenue collected from the taxes which are imposed by the centre or the income collected from the non-tax variables.
- Tax income included the corporation tax, customs duties, excise duties, GST, and others.

* While on the other hand, taxable income includes interest receipts, outsourcing of grants in aid, dividends, and gains, receipts from the Union Territories, etc.

Expenditure Component

* The expenditure components formed by the government provided funds for several works, including payments of pensions, emoluments, salaries, generating assets, development, health, and various other areas according to the budget.

Framework of Fiscal Deficit

About India's fiscal policy agenda, there are some interesting facts, such as-

* Directives for the formation of a Finance Commission every five years have been provided by the Indian constitution to provide the basis for the assignment of some revenues of the centre to the state government and on fiscal matters providing the medium-term direction as the state taxing capacity is not necessarily proportionate accordingly with their spending responsibilities.
* An account of its proposed taxing and spending provisions is put by the government before the Parliament for the legislative debate in the Union Budget, and the approval of the provisions is also an important part of the fiscal policy.
* To be concerned with Fiscal discipline, an Act was passed- the Fiscal Responsibility and Budget Management (FRBM) Act, 2003.

Difference Between Fiscal Deficit and Revenue Deficit

The excess of Budget Expenditure over the Budget Receipt other than borrowing is known as Fiscal Deficit(FD) while the excess of Revenue Expenditure over the Revenue Receipts is known as Revenue Deficit.

* Fiscal Deficit = Budget Expenditure – Budget Receipts (excluding borrowings), while the Revenue Deficit = Revenue expenditure –Revenue receipts.
* A Fiscal Deficit indicates the total government borrowings during a fiscal year, while a Revenue Deficit indicates the inefficiency of the government in reaching its regular or recurring expenditure.

Fiscal Deficit of Current Year

With a deficit of roughly 18.21 lakh crore rupees, the Fiscal Deficit of the government reached 9.3 per cent of GDP in Financial Year 2020-2021.

* In the current Financial Year (FY 2021-2022), the government expects a deficit of 6.8% of GDP and aims to bring it below 4.5% by 2025-26.
* According to the database shown by the Controller General of Accounts (CGA), at the end of October 2021, the Fiscal Deficit of the Union Government is seen to be 5.47 lakh crore Rs which is 36.3% of the Budget Estimate(BE).
* The Center must take measures to limit the Fiscal Deficit up to 3% of the GDP by 31st March 2021, according to the Fiscal Responsibility and Budget Management Act, 2003. However, the government should target a Fiscal Deficit of 3% of the GDP in the years up to 31st March 2020, cut it to 2.8% in 2020-21 and 2.5% by

2023 by the 15th Finance Commission recommendation under the chairmanship of NK Singh.

- The central government should reduce its Fiscal Deficit to 4% of GDP and its outstanding liabilities to 56.6 per cent of GDP by 2025-2026, on the recommendation of the 15th Finance Commission under the chairmanship of NK Singh (set up in 2016).

Reasons for High Deficit

There are mainly two reasons for the Fiscal Deficit:

- Either less revenue realization like during pandemic due to the closing of business and other commercial activities, the revenue collection has dipped lowest; and the second reason is increasing expenditure by the government, due to the government's obligation towards many schemes like- health, education, etc.
- The expenditure is high, and the obligation increases further during the pandemic when the government has taken various steps like providing free food, vaccination, and direct benefit transfer(DBT), among others, which further increases the burden on the finances resulting in further increasing Fiscal Deficit.

Fiscal Responsibility and Budgetary Management Act (2003)

The Fiscal Responsibility and Budgetary Management Act was enacted in Parliament in 2003 to bring fiscal discipline and improve microeconomics management and overall management of public funds by moving towards a balanced budget.

- This Act was based on the Gramm Rudman Act 1985 of the USA, which was based on the concept of a balanced budget.
- Following the enactment of the FRBM Act, the government constituted a task force headed by Dr Vijay Kulkar to draw up the medium-term framework for fiscal policy to achieve the targets of the FRBM Act.
- The task force submitted its report in July 2004, and then the Act was implemented in the country.

Main objective/purpose of FRBM Act

- To eliminate revenue deficit and build revenue surplus by 2008-09.
- To bring down the Fiscal Deficit to a manageable 3% of GDP by March 2008.
- Note- The above-mentioned target was not achieved, so this FRBM Act was discontinued in 2009.

FRBM Act Review Committee

- The targets of the FRBM Act 2003 were put up several times. In 2012 and 2015, notable amendments were made, but a target was not achieved.
- As per the Union Budget 2016-17 government constituted a committee to review the FRBM Act under the chairmanship of N.K. Singh.

- So the committee recommended that the government should target a Fiscal Deficit of 3% of the GDP in the years up to 31 March 2020 and cut it to 2.8% by March 2021 and cut it to 2.5% by March 2023.