Fiscal Responsibility Act in itself may not help reduce revenue deficit

UTTAM GUPTA

UNDER the Fiscal Responsibility Act, the government has proposed complete elimination of revenue deficit in five years beginning 2001-02 and corresponding reduction in fiscal deficit from existing 5 per cent (target for 2000-01) to 2 per cent by 2005-06. To gauge the enormity of the challenge that the authorities have set before them, let us look at the following.

The revenue deficit during 2000-01 being Rs 77,000 crore, reducing this to NIL by 2005-06 would require a reduction of about Rs 15,000 crore per annum. However, considering the fact that interest payments will continue to increase and assuming that the increase will be at the same pace as during the last five years or Rs 8,000 crore per annum, the required adjustment in revenue and expenditure (ignoring interest payments) will be a whopping about Rs 23,000 crore per annum.

This is an uphill task, specially against the backdrop of the fact that during the last five years, revenue deficit increased @ Rs 9,000 crore per annum despite overriding emphasis on maintaining fiscal discipline all through. But the government has exuded confidence. It proposes to monitor revenue and expenditure streams on a quarterly basis, identify the deviation of actual from the target and initiate immediate corrective steps to plug these. The entire exercise will be under the watchful eyes of Parliament as the Act requires the finance minister to report various actions to it.

What kind of corrective steps does the government have in mind in the event of a shortfall in realising the target for revenue or expenditure which is inevitable in view of the highly theoretical targets? It has indicated that if expenditure under any given sub-head is higher, then expenses under some other sub-head will be proportionately reduced and vice-versa. Likewise, adjustments would be made on the revenue side. If the respective targets for revenue and expenditure are still not met, then perhaps, cross adjustments may be contemplated i.e., shortfall in revenue could be offset by reduction in expenditure.

Each major item of expenditure is determined by a certain set of factors. For instance, food subsidy depends primarily on the number of families below poverty line (BPL), their monthly entitlement of foodgrains and the price at which these are made available to them. The subsidy on fertilisers depends on the quantum of production/sales, selling price and reasonable cost of production and distribution, which in turn, depends largely on cost of feedstock and other inputs. The wages and salaries bill depends on the number of employees, staffing pattern, pay scales etc. Likewise, each item of revenue has its own dynamics.

Now, if expenditure under any of these subheads has to be significantly reduced the government will have to take appropriate decisions in regard to changes in the underlying factors. For instance, if fertiliser subsidy payments have to be reduced, there either has to be an increase in the selling price of urea or reduction in cost of feedstock or in production. Likewise, reduction in food subsidy will require increase in issue price of foodgrains or reduction in entitlement of BPL families or reduction in cost of procurement, handling and distribution.

VIEWPOINT

Considering the far-reaching impact of such decisions on welfare of general masses specially poor farmers and consumers of foodgrains as well as the political fall out, invariably, the Government has to evolve a consensus (compulsions of contemporary coalition politics make it all the more necessary) which is a time consuming process. In sharp contrast, the Act will require sweeping changes and that too in a small timeframe. For instance, if, by working on urea price, a shortfall of about Rs 2,000 crore has to be made up in six months, the increase will have to be a whopping about 40 per cent.

In this context, a quick review of developments in the past will reveal that far from substantial changes in small time frame—as implied under the Act—the government faced a tough terrain in bringing about even small changes over longer time-frame. Thus, for instance, the price of fertilisers was not raised during the whole of the 80s. In July 1991, when Manmohan Singh raised these by 40 per cent, the Opposition got it whittled down to 30 per cent even as small and marginal farmers were fully exempt.

In August 1992, the selling price of urea was reduced by 10 per cent. After a lull for two years, only in June 1994, the price was raised by 20 per cent. Then, there was a break for another three years and only in February 1997, the price was raised by a meagre 10 per cent. Later, in June 1998, when, Yashwant Sinha proposed an increase of 27 per cent (euphemistically described as an increase of Rs 1 per kg), it was fully rolled back in less than two weeks. In the last two years, the price was increased by a modest 9 per cent in January 1999 and a further 15 per cent in February 2000.

At the same time, the government unhesitatingly resorted to steep increases in prices of hydrocarbons which, while boosting the profitability of its undertakings in the oil and gas sector viz., IOC, ONGC, GAIL etc., led to unprecedented increase in outgo on fertiliser subsidy. According to a calculations by the Fertiliser Association of India (FAI), between 1990-91 and 1999-2000, on this account alone, domestic production costs went up by a whopping about Rs 8,000 crore. After setting off extra realisation from increase in urea price, increase in subsidy was Rs 4,500 crore.

Despite significant increases in the issue price of foodgrains to match rising procurement prices, the subsidy bill has increased. This is largely the result of the increasing cost of handling and distribution as well as the high cost of nursing excessive stocks in the Centre's granaries. A dent on food subsidy can be made only if the existing system is completely overhauled to facilitate cost-effective and efficient operations.

Unfortunately, this aspect has received scant attention so far and it is most unlikely that mere acceptance of some obligations under the Act would lead to any change of mindset.

Coming to expenditure on wages and salaries while implementing the recommendations of the Fifth Pay Commission, the government also committed itself to significant downsizing. But for the latter, the former could not have been pushed through. In retrospect, what we find is that in addition to the burden of skyrocketing emoluments, the exchequer also has to put up with a significant jump in the number of employees, from 3.745 million to 3.856 million. One wonders whether the Act will facilitate any meaningful reduction in the number of employees (say, 10 per cent by 2005 as recommended by the ERC).

In short, the government's inability to take harsh steps (contributed in no small measure by the negative attitude of various political parties) has led to a situation whereby much less stringent targets set in various budgets during the 90s—than contemplated for the next five years—were not met. It is most unlikely that things would change with the mere passing of Fiscal Responsibility Act. The objective of wiping out revenue deficit five years from now will remain a distant dream.

(The writer is chief economist, Fertiliser Association of India. The views expressed are his own)