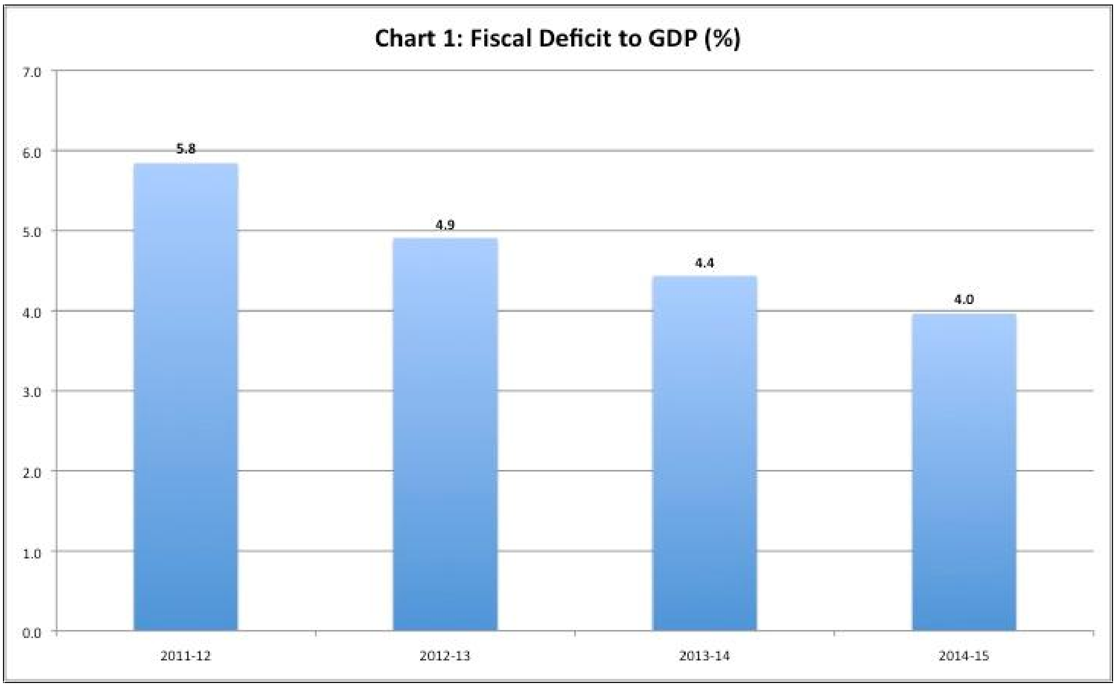
Fiscal Consolidation through Austerity*

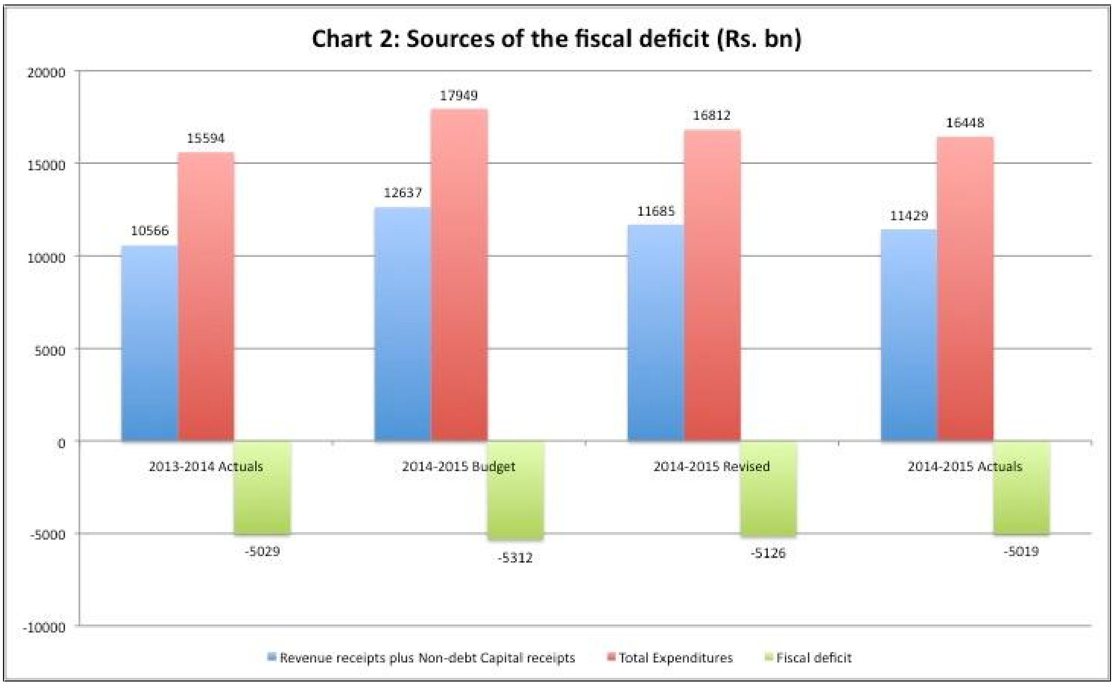
C.P. Chandrasekhar

On May 17, the Controller General of Accounts released the audited provisional accounts of the central government for 2014. Unlike the revised estimates in budgetary documents, these figures include actual figures for the month of March. A terse Statement from the Press Information Bureau announcing the release of the provisional result began thus: "As a result of prudent policies and commitment to fiscal consolidation, the fiscal deficit at the end of 2014-15, stands at Rs. 5,01,880 crore which is 98% of the projected figure in RE 2014-15. Fiscal deficit as a percentage of GDP is 4.0% as against the RE of 4.1%. The Union Government is firmly committed to path of fiscal consolidation and this is a step forward." Indeed the figures point to a continuous reduction of the fiscal deficit to GDP ratio from 5.8 per cent in 2011-12 to 4 per cent in 2014-15 (Chart 1), which makes the 3.9 per cent target set for 2015-16 seem easy for this government to achieve.

Recall that the commitment to fiscal consolidation began with the launch of the economic adjustment programme adopted after the balance of payments crisis of July 1991. Even two decades after that the targets the government set for itself had not been realised. However, much has been done over the last few years. Thus, even those who believe that fiscal consolidation is not what is required in the current environment must take note of this trend.



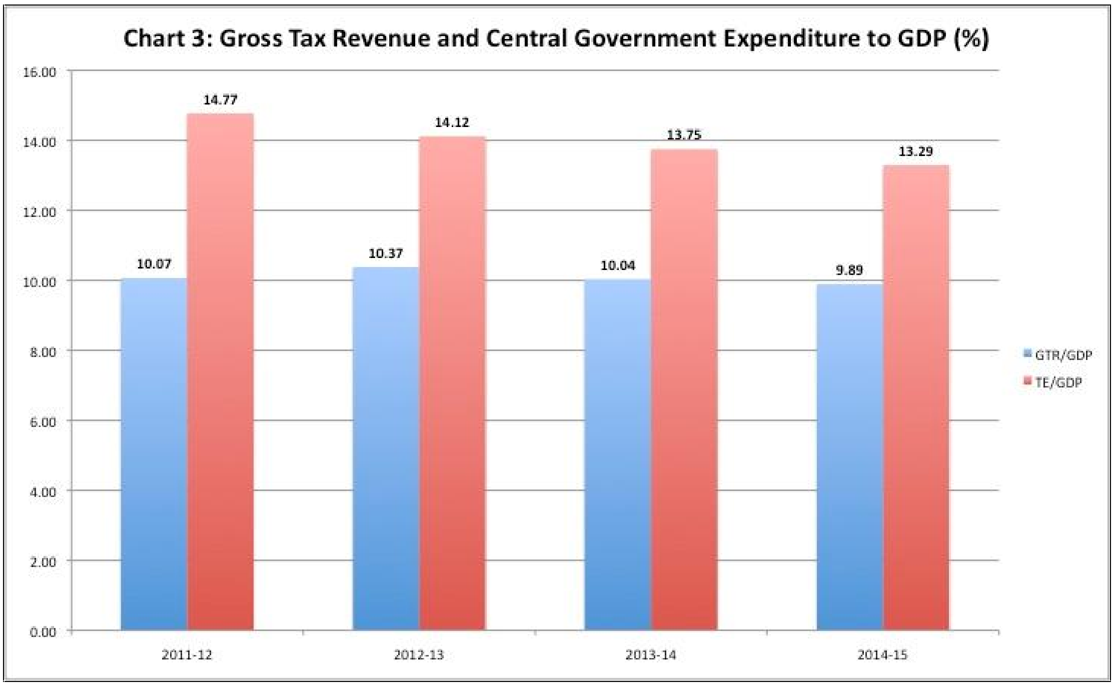
The question then is how the government has in recent years managed to realise a large part of the process of 'consolidation'. The figures presented in Chart 2 provide much of the explanation. What they show is that the Budget for 2014-15 presented by the current government had projected that while total central government expenditure would rise by a little over 15 per cent in nominal terms (resulting in a decline in the expenditure to GDP ratio from 14.1 per cent to 13.8 per cent, tax and non-tax revenues and receipts in the form of non-debt capital receipts (which are excluded from the fiscal deficit) would rise by close to 20 per cent. As a result though the fiscal deficit in nominal terms was to rise by 5.6 per cent, the faster rise in nominal GDP would bring the fiscal deficit to GDP ratio down from 4.4 per cent to 4.1 per cent. That is, the next step forward in a less ambitious fiscal consolidation programme was to be achieved partly through mobilising additional receipts and partly by reining in expenditures. In this the Finance Minister hoped, would be helped by receipts from disinvestment, which are not revenues but 'one-off' receipts from the sale of assets.



When the revised estimates for 2014-15 were made available, it became clear that the consolidation was on track (with the absolute value of the fiscal deficit amounting to just Rs. 5,126 billion, which though higher than the Rs. 5,029 billion 2013-14 figure, was lower than the budget estimate of Rs. 5,312 billion). However, the method of consolidation appeared to be different from that planned for. Inflows from tax and non-tax revenues and non-debt capital receipts were estimated to have risen by only 10.6 per cent as compared with a planned 19.6 per cent. But expenditures had been curtailed to more than match this shortfall, growing at just 7.8 as compared with a budgeted 15.1 per cent. In the event, the absolute value of the fiscal deficit rose by just 1.9 per cent as against the budgeted 5.6 per cent, and the deficit to GDP ratio was placed at 4.1 per cent as compared to 4.4 per cent in the previous year. In sum, the rise in receipts was far less than budgeted, and deficit reduction came to depend on expenditure reduction.

As Chart 3 shows, underlying this 'alternative' method of fiscal consolidation being adopted in practice is a fundamental failure to raise the tax-to-GDP ratio. That ratio of the Centre's gross tax revenue to GDP has stagnated at an abysmally low average of around 10 per cent since 2011-12. The effort to neutralise this with enhance receipts from disinvestment has not worked, necessitating a reduction in total central expenditures relative to GDP from 14.8 per cent in 2011-12 to 13.3 per cent in 2014-15. Even the new government, with its commitment to 'reform' and the decisive mandate it has, was not able to realise its own ambitious target of obtaining Rs.

586.25 billion from that source during 2014-15, having to be satisfied with just Rs. 263.53 billion, which was not much higher than the Rs. 243.62 billion obtained by the previous government in 2013-14.



The actual figures released recently indicate that this distorted form of consolidation that relies on expenditure reduction rather than revenue mobilisation has been more severe than even the budget visualised (Chart 2). Actual receipts required to keep down the deficit were even lower than the revised figures in the budget, necessitating even greater expenditure reduction. In its effort at expenditure compression, reflected in the austerity measures imposed by the Finance Ministry towards the end of the last year, the government seems to have gone beyond its own expectations. Expenditures have been cut so much that the nominal value of the fiscal deficit (Rs. 5,019 billion) is not just below the budgeted and revised figures for 2014-15, but even below the 2013-14 figure (Rs. 5,029 billion).

This attempt at fiscal consolidation through austerity is reflected in budget 2015-16 as well, with allocations for crucial ministries cut to ensure deficit reduction. The Minister for Women and Child Development has reportedly already complained against such cuts in a letter to the Finance Minister. It is likely that those cuts would have to be larger given overoptimistic projections of revenue buoyancy and increases in non-debt capital receipt. That would not only affect growth adversely, but also have damaging effects on welfare.

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