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Gross Fiscal Deficit and its Financing in India: A Study of Recent Trends

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Abstract
Fiscal Deficit has been a matter of great concern for the Indian economy. In recent times, thanks to a number of policy initiatives, fiscal deficit is said to have been brought under a manageable rate in India. In fact, financing of Gross Fiscal Deficit is equally important as the controlling of fiscal deficit. This paper looks into the trends in GFD in India, and in more detail, it dwells into the changes in the sources of financing of GFD. The paper analyses trends in different sources of financing GFD viz. external financing and internal financing sources. The paper concludes with the note that internal financial market borrowing has turned out to be the major source of financing GFD in India in recent times.

Keywords: Gross Fiscal Deficit, Budget Deficit, External Finance, Internal Financial Market Borrowing, Draw Down on Cash Balances

Introduction

It is an indisputable fact in the public finance affairs of most of the economies that Fiscal Deficit (FD) and its various sources of financing have become a widely and deeply discussed topic. This is partly on account of the fact that of all indices of fiscal health viz. Revenue Deficit (RD) and Budget Deficit (BD) and so on, the Fiscal Deficit has been widely recognised as an accepted measure of the fiscal position of a country. In India the use of fiscal deficit has been considered as a recent development in the arena of fiscal economics. The shift from Budget Deficit to Fiscal Deficit has paved the way for far reaching consequences in the overall administration and execution of fiscal affairs in the country. The very reason for considering the Fiscal Deficit as a true indicator of fiscal position is its exclusion of borrowing as a part of the receipts of the government, which makes it capable of showcasing the exact picture of the fiscal position of a country. The formal of adoption of Fiscal Deficit as a measure of fiscal position of India really got started with the presentation of the budget in 1992-93 by the then Finance Minister Dr. Manmohan Singh. It is true that prior to 1992, the entire discussion and analysis of the fiscal position of India hovered around Budget Deficit which simply depicts the casual difference between the total budget receipts and expenditure in a financial year which actually was insufficient to unearth the real fiscal position of India. The absence of a true indicator fully capturing the fiscal position of the country in fact acted as a hindrance to the effective implementation of macroeconomic policies in India. The repercussions of many policy initiatives remained unknown either partially or fully on account of the misrepresentation of fiscal position of the centre and state governments in India owing to excess dependence on Budget Deficit indicator.

From a macroeconomic perspective it has been widely held that a relatively low level of deficit be it budget or fiscal and a consequential low levels of public debt are essential prerequisites for fuelling growth that would ameliorate hard-core real issues like poverty and unemployment that plague the economy incessantly for a quiet long period of time albeit the implementation of many targeted programmes and policies. In other words, in order to have a better social outcome from the technically managed macroeconomic policies, a low level of deficit and public debt seem to be all the more important. Keeping this in view, a fiscal consolidation strategy took off in 1991 with the intention of holding the fiscal deficit at the possible minimum point, and consequently by 1996-97, the fiscal deficit as a percentage of GDP in India plummeted to 4.1 percent from 6.6 percent in 1991 (GoI, 2009).

Research Problem, Objectives and Methodology

The real problem that the governments confront in India over the years is related to the financing of the fiscal deficit. Once the deficit between receipts and expenditure excluding borrowing is reckoned with, it is the issue of the governments to trace out various fiscal avenues to bridge the gap in a way as it does not affect the growth impulses of the economy negatively. Broadly speaking, there are two ways to finance the fiscal deficit: one is to seek external sources of finances and the other, perhaps the most important, is to rely on certain internal sources of revenue including borrowing from the open market, running down the cash balances and internal finance market borrowing. This paper intends to examine the trends in fiscal deficit in India over the years starting with 1991. Apart from examining the trends in fiscal deficit the paper also looks into the trends in various sources of financing of fiscal deficit in India. The study completely relies on time serious data for the period 1991 to 2024 which has been compiled from the RBI data sources. Trend lines and correlation have been used for the analysis of data.

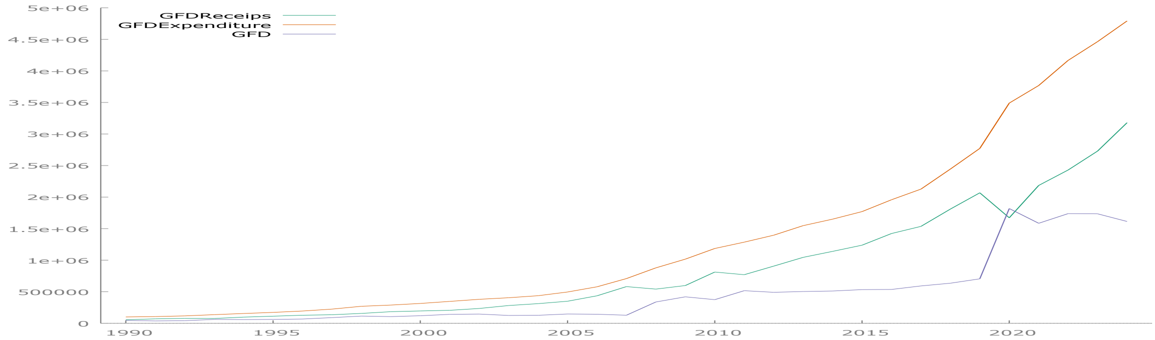
Literature Review

Studies mainly focused on the impact of fiscal deficit on key macroeconomic variables. Studies cite two poles apart stance as far as fiscal deficit is concerned: that fiscal deficit can dampen the economic growth on one side (monetarists view) and if used wisely it can spur economic growth (fiscalist view) on the other. The econometric analysis of the impact of fiscal deficit in India rightly proved that fiscal deficit has had adverse repercussion on the growth of the economy. Nevertheless, it has also been pointed out that if the fiscal deficit money is used in sectors that add up to the capital stock of the economy, it can accelerate economic growth (Ramu & Gayithri, 2016). In a paper discussing the issue of fiscal deficit and government debt it is argued that large structural primary deficit relative to the GDP of the country had adverse consequences on the growth prospects of the economy. Hence, along with bringing down the fiscal deficit, the study points towards the necessity of reducing the debt to GDP ratio of the country as well (Rangarajan & Srivastava, 2005). Fiscal deficit has had its adverse impact not only on the economic growth of the economy but on the stock prices that often, it is argued, travels not in consonance with the general trend of the economy. A study on the connection between fiscal deficit and stock performance evidently shows that in the long run fiscal deficit has negative impact on the prices of stock while in the short run there is hardly any relationship between the two (Joshi & Giri, 2015).

Trends in Fiscal Deficit (1991 to 2024)

In order to analyse the trends in fiscal deficit, we intend to look at three indicators: GFD Receipts, GFD Expenditure and GFD. It is obvious from the figure that GFD expenditure has always been increasing over the years. On the other hand, GFD Receipts has shown volatile trend since 2018 (Figure No.1). It appears quite interesting to note that GFD in 2019 really made a U-turn by skyrocketing to a high growth rate, and since then it has been increasing in absolute terms. To put it briefly, the widening GFD that India witnesses in recent times can mainly be attributed to burgeoning fiscal deficit expenditure.

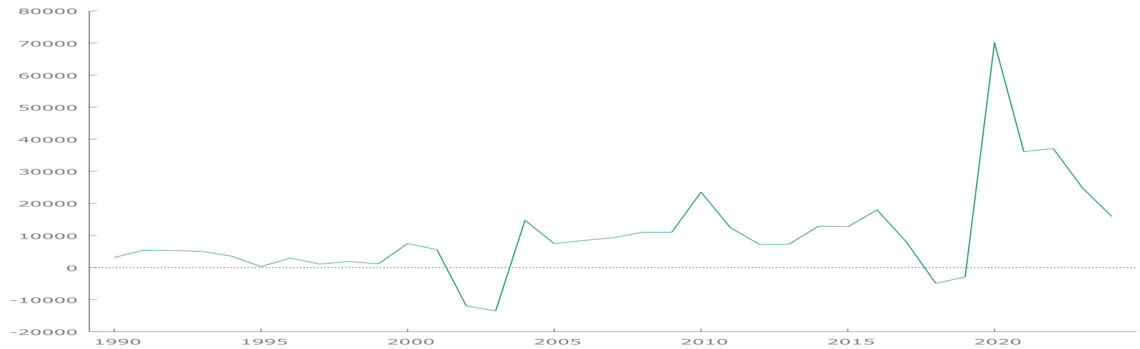
Figure 1 Trends in GFD Receipts, GFD Expenditure and GFD



How has India been financing its fiscal deficit?

Having discussed the general trend in FD expenditure, FD receipts and GFD, now we turn to describe how fiscal deficit has been financed in India during the period between 1991-2024 (Figures 2, 3, 4, 5 and 6). As we know, there are, broadly speaking, two methods to finance the fiscal deficit: External Financing and Internal Financing. In the case of external financing, it amounts to pumping in more money to India from outside, leading to an increase in money stock in due course of time. In the case of internal financing, the picture appears to be fairly different thanks to the reason that internal financing can be considered as a shift of money from one kind of people to another kind of wealth holders within the county itself, and hence, it does not in any way augment the money that moves around within the economy.

Figure 2 External Financing



Since internal source of financing is just a transfer of income from one section to the other within the country, its consequences are a little compared to the issue of external finance. Coming to the external financing it has been estimated that external financing has grown at a rate of just 5 percent over the years under the consideration of this study, showing that the dependence of external financing has been of limited use in India. Contrast it with the growth rate of GFD over the same period which has been estimated to be the order of near 11 percent. However, it is interesting to point out that our reliance on internal financing of FD has been on higher path over the years which is evident from the fact that total internal financing has grown almost at the same pace with the growth in FD (11 percent). It is unambiguous to mention here that the void created by the external financing has been taken over by the internal financing over the years. Of the various parts of internal financing, further it is interesting to note that the internal financial market borrowing has grown at a rate of 15 percent over the years, clearly showing that financial market in India has been playing dominant role in financing the FD of India. Other borrowings have grown only at rate of 8 percent over the years. In the source of internal financing the Draw Down of Cash Balances is estimated to have grown only at a rate of 7 percent over the years. Thus it is evident that internal financial market borrowing has emerged out to be the main source of financing of GFD in India in recent years.

Figure 3 External Financing of GFD: Growth Trends

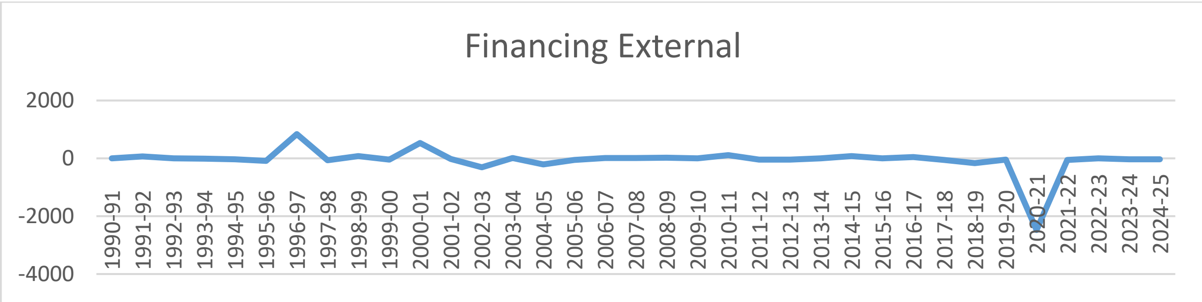
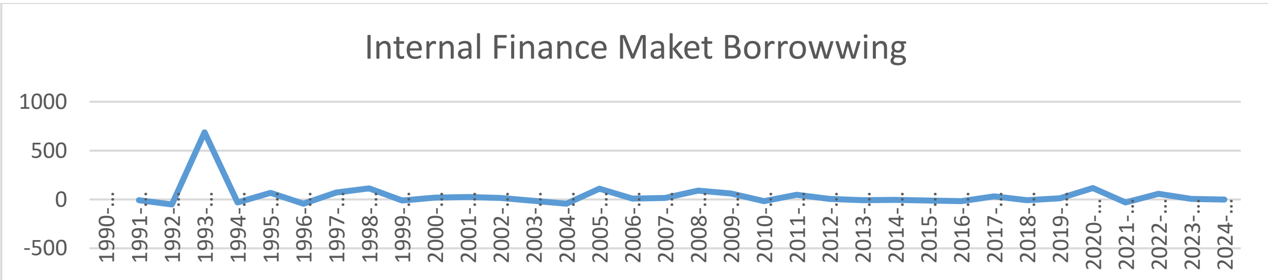


Figure 4 Growth Rate in Internal Finance market Borrowing



Moving further, the study makes use of the correlation analysis in order to show the relation between GFD and its different sources of financing. While correlation between GFD and internal financing turns out to be positively perfect and significant, in the case of external financing it appears to be of the order of .75 which shows that although correlation between GFD and external financing is strong and positive, it does not appear to be as strong and positive as in the case of internal source of financing. Internal financial borrowing is highly correlated with GFD (.968) and it seems significant as well whereas Draw Down of Cash Balances does not have any significant relation with the GFD. All these clearly point towards the increasing role being played by internal financial market borrowing in financing the GFD of India in recent times.

Figure 5 Draw Down Cash as a Source of Internal Finance

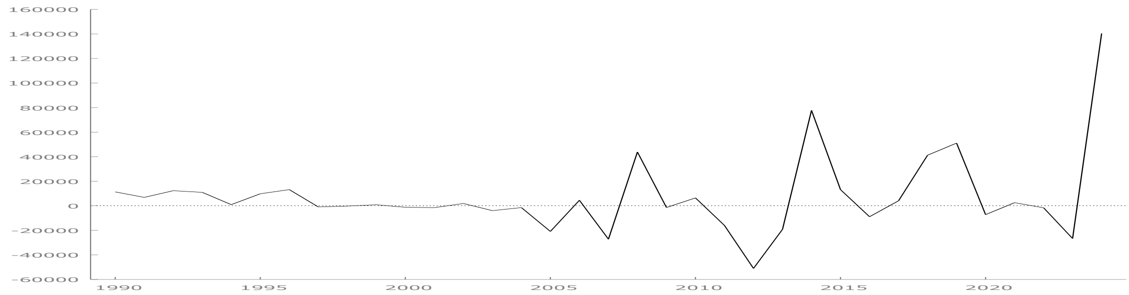
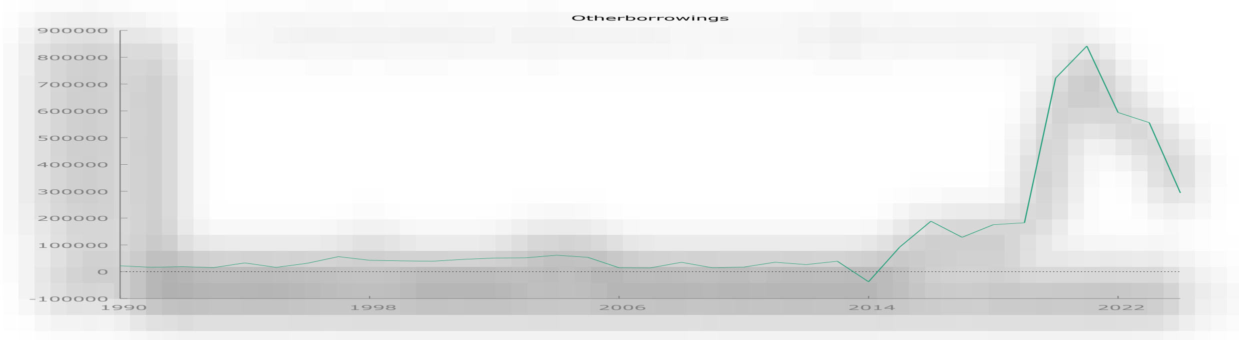


Figure 6 Other Market Borrowing



Conclusion

The present study has been designed to understand the pattern of financing Gross Fiscal Deficit in India during the period 1991 to 2024. Using time series data pertaining to GFD and its sources published by RBI, the study has found that there have been changes in the relative role being played by different sources in financing the GFD in India. looking at data it is obvious that in recent times, India has been able to scale down the importance of external sources in financing the GFD in India. Among the three sources of internal finance, it has been found that the internal financial borrowing has assumed a significant role in financing the GFD of India in recent times. This shows the growing strength of Indian financial sector and the resilience of the economy. The decline in the importance of market borrowing and external finance in financing the GFD of India clearly shows the remarkable change that the Indian fiscal condition has attained in recent times.

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