People

Fiscal Crisis and Governance

Ballooning fiscal deficit is the major problem plaguing the minds of policy makers, economists and thinking citizens. Shorn of all jargon, fiscal deficit is nothing but the excess of government expenditure over revenues. The finance ministers of the past effortlessly bridged this gap by resorting to two ‘simple’ measures – deficit financing or borrowing. Deficit financing means liberally printing new currency; borrowing means taking our money in banks at absurdly low interest rates through the mechanism of Statutory Liquidity Ratio (SLR), which led to high inflation and increased rates of interest for general investment. This in turn led to economic slow down resulting in the ‘Hindu Rate of Growth’. While the tax revenues are increasing, they are not enough to match the expenditure growth, forcing governments to borrow more money to bridge the revenue gap. Investments in public sector are yielding negligible returns. As finance ministers no longer have the luxury of resorting to uncontrolled deficit financing or compulsory borrowings from banks at artificially low rates, borrowings had to be made at the market rates of interest.To make matters worse, Inder Kumar Gujral's cabinet took the populist decision to implement the 5th Pay Commission’s recommendation to significantly enhance the wages of government employees but put proposals to improve productivity and reduce workforce on the back burner. The increase in wages of the Union's employees had a cascading effect on the wages in the States and public sector resulting in mounting fiscal deficits and borrowings. Today, the combined fiscal deficit of the Union and States is of the order of 10 percent of the GDP or over Rs. 2,00,000 crores per year. Alarmingly much of this borrowing is going to meet the revenue deficit. The government introduced in Parliament recently The Fiscal Responsibility and Budget Management Bill 2000, by which the governments at the Union and States would be compelled to reduce deficits and borrowings every year by 10 percent or more. But is the Fiscal Responsibility Act the magic wand we had been waiting for? Can it wave away the fiscal deficit? Over 50 percent of the tax revenues of the Union now go towards debt servicing. Interest payments, defense expenditure, employees' wages and pension all put together exceed the total revenues. Apart from this we have other obligations of plan expenditure, transfer of resources to States (over 40 percent of the tax revenues), administrative costs, subsidies and contingencies. Now look at the States. In almost all States the wage and pension bills range from 80 to 160 percent of the total tax revenues. The States have their own obligations — interest payments, states' share of plan budget, administrative costs, subsidies and contingencies like natural disasters etc. How can the fiscal deficit be reduced if everything else is to remain unchanged? The proper way would be increased revenue mobilization through a high, sustained economic growth of 8-10 per annum. But unlike China, we haven't created the required base to sustain such a growth rate. Low levels of literacy, poor health care, infrastructure bottlenecks, inadequate development of natural resources, and high level of corruption and extortion have inhibited investment and reduced productivity. We are left with the more painful options of further increasing taxes, reducing subsidies, decreasing wage and pension bills and selling the public sector units. Selling public sector units is a one-time option but we have shown no skill to quickly sell these assets and retire national debt. But the people are not going to accept higher taxes unless they think they can get something in return. Lower subsidies are not politically feasible, unless the poor are compensated in some other form. Reducing the number of employees or the wage bill is a pipe dream in a country with exceptional job security and low level of political legitimacy. All these are not merely fiscal problems; they are fundamental governance problems. Fiscal deficit cannot be addressed by budgets and laws; it requires political will and skill to restructure governance. There are no shortcuts. Time is running out. Further delay and dithering will deepen the fiscal crisis, and lead to a possible fiscal collapse with runaway inflation, resulting in breakdown of public order and severe political and social strife. A decade ago the erstwhile USSR collapsed precisely because the crisis was not addressed squarely and in time, and the results were horrendous. Now is the time for the governments to pursue the long overdue fundamental governance reforms and for the people to seek the link between taxes and public services and authority and accountability.

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