DEFICIT SPENDING : A MULTIPLICITY OF CONCEPTS

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In this article the author highlights the fact that the concept of a budgetary deficit admits of many definitions and measures. Each one of them has its theoretical and policy relevance and enables us to assess some dimensions of the fiscal performance of the government.

Every modern Government, irrespective of its ideology and other features, suffers from an irresistible temptation to increase its expenditure. Spending is an inherently pleasant task while raising revenue resources for financing it an unpleasant one. This fact, therefore, leads to the widespread phenomenon of deficit spending. An evidence of this is the mounting internal indebtedness of many governments.

Economic growth implies increasing monetisation of the economy coupled with a corresponding need for money and credit supply. Furthermore, economic growth can be sustained only if it is backed by a sound financial system. Public debt is indispensable in ensuring that the credit instruments in the financial system are adequate in both volume and variety. By implication, deficit spending can be used in accelerating economic growth. Further, the government can use deficit spending for shifting productive resources of the economy into basic and key industries as also for providing necessary infrastructure.

However, the concept of deficit spending is a hazy one and admits of several definitions. Its beneficial effects, if any, as also its tolerable doses are obviously related to the way it is defined and sources of its financing. Ordinarily speaking, a fiscal or budgetary deficit should mean an excess of expenditure over revenue. This excess, in turn, may be financed through borrowings, sale of public assets and drawing down of cash balances. In India, however, a budgetary deficit is officially defined in a very narrow sense of the term. All long-term borrowings including those from the RBI (that is, loans with a maturity of 12 months or longer at the time of issue), all 'floating loans' like receipts from small savings, provident funds, etc. all external borrowings and all grants are included in 'revenue' and budgetary deficit is the excess of public expenditure over 'revenue' defined in this manner. Accordingly, budgetary deficit is defined as that part of public expenditure which is met by 'short-term' borrowings (more precisely, through the sale of

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91-day treasury bills to the RBI) and drawing down of cash balances. This measure of budgetary deficit is usually referred to as the 'uncovered deficit' in official circles.

The official stand for defining budgetary deficit in this narrow way is that this term should have an economic rather than an accounting basis. By implication, only that portion of public expenditure which adds to the effective money supply and is therefore pro-inflationary should be included in a measure of budgetary deficit. However this reasoning is defective because all borrowings from RBI (including the longer-term ones) do add to money supply in the country. Similarly, borrowings from other banks add to their liquidity and hence to their capacity to create credit.

The Chakravarty Committee appointed by the RBI pointed out the defects in the existing official measure of budgetary deficit and the need to include the entire net RBI credit to the government in it. However, the official measure of budgetary deficit continues to be the same. In addition, the amount of net RBI credit to the government is also shown and termed monetized deficit. Further, we are also provided a measure of 'fiscal deficit' which is the excess of public expenditure over public revenue (excluding borrowings of all kinds). In addition the deficit on revenue account of the budget is also highlighted. This last measure should not be confused with current account deficit which is a part of balance of payments and covers items other than capital flows.

Budgetary deficit as defined above implies creation of extra purchasing power in the hands of the Government without corresponding production of goods and services. There is, therefore, an increase in aggregate demand and prices. This leads to two results:

(1) The private sector loses a part of its real resources to the government and is effectively taxed through budgetary deficit.
(2) The inflationary forces are further fed by the demand behaviour of profit earners and the investment pattern of the authorities.

An ill-effect of the price rise is the income and wealth inequalities. This is normally coupled with an increase by profit earners in their consumption of luxuries and other nonessential goods. Apart from this, the authorities usually invest their resources in projects with long gestation periods. The production from these investments starts coming to the market with lapse of some time. The process of investment expenditure, on the other hand, brings about purchasing power into the hands of the public and adds to demand immediately. All told, unless deficit financing is within the limits set by the expansion of monetisation and expansion of output, inflationary pressures develop.

TABLE : Government of India Receipts and Disbursements for 1991-92
(Rs. in Crores)

I.	Revenue Receipts	66,047
	(a) Tax-Revenue	50,070
	(b) Non-Tax Revenue	15,977
	(i) Interest	10,922
	(ii) Non-Interest	4,108
	(iii) Grants	947
II.	Capital Receipts	38,528
	(a) Recoveries	6,021
	(b) Borrowings, other than through 91-day T. bills	27,527
	(c) Other Capital Receipts	1,942
	(d) Sale of Public Assets	3,038
III.	Total Receipts	104,575
IV.	Expenditure on Revenue Account	82,308
	(a) Interest Payments	26,563
	(b) Non-Interest Expenditure	55,745
V.	Expenditure on Capital Account	29,122
	(a) Loans and Advances	11,678
	(b) Capital Outlay	17,444
VI.	Total Expenditure	111,430
VII.	Borrowings Through 91-day T. Bills and Drawing Down of Cash Balances	6,855
1.	Revenue Deficit (IV-I)	16,261
2.	Deficit on Capital Account (V-II)	(-)9, 406
3.	Budgetary Deficit [(VI-II)]= (1+2)	6,855
4.	Fiscal Deficit [VI-{I+II (a)+II (d)]} or [II (b)+II (c)+ VII]	36,324
5.	Net Fiscal deficit [Fiscal Deficit-V (a)]	24,646
6.	Primary Deficit	
	(a) [Fiscal Deficit- IV (a) + I (b) (i)]	20,683
	(b) Fiscal Deficit- IV (a)	9,761
7.	Net Primary Deficit	
	(a) [Primary Deficit -V (a)] or FD-V (a)-IV (a)+ I (b).(i)	9,005
	(b) FD-V (a)-IV (a)	(-) 1,917

CONCEPTS OF DEFICIT

Before we take up alternative measures of deficit spending and illustrate them, it would be useful to present a break-up of the receipts and disbursements of GOI into relevant categories and sub-categories in an appropriate

and usable form. (See Table).

I (a) This item represents Centre's share out of the tax revenue collected by it. It is therefore gross tax collection less share of States less Assignments of UT taxes to local bodies.

I (b) (i) This item represents interest received on loans extended by the Centre to various parties like State Governments, Railways, P & T, Government employees, Foreign Governments, etc.

I (b) (ii) This item includes dividends and profits, receipts in the process of performing various governmental duties and functions and exercising of sovereign rights, non-tax revenue of UTs without Legislature, and income from fiscal services. The last component (fiscal services) represents profit on creation of government currency, that is, the excess of the face value of government currency during the year over its cost of production.

I (b) (iii) This item is self-explanatory. It includes grants from abroad also.

II (a) This item represents repayment of loans to the Centre by its debtors. This item, however, does not include recoveries of

(i) Ways and Means Advances to States;
(ii) Loans for Agricultural Inputs; and
(iii) Loans to Government Servants, etc.

Correspondingly, therefore, all estimates of deficit (except that of Revenue Account) are affected by this omission.

II (b) & II (c) These components represent all varieties of borrowings by GOI except those through the sale of 91-days treasury bills [borrowings through 182-days and 364-days bills are included in item II (b)]. These borrowings are net amounts, that is, gross borrowings minus repayments by the GOI on its outstanding loans. For this reason, the portion 'Securities Issued to International Financial Institutions' (These securities are deposited with RBI by the Centre) gets totally omitted because it represents simultaneous capital receipts and disbursements of equivalent amounts.

II (d) This represents sale proceeds of some assets sold by the Centre. More specifically, this came into existence on account of disinvestment of some equity share holdings in PSUs in the wake of new policy of liberalisation. The Centre claims that the sale of these assets reduces its budgetary deficit by an equivalent amount. Many analysts and the World Bank do not agree with this view. However, the viewpoint of the Government can be defended by pointing out that additions to Government assets through its capital expenditure and through extending loans to other parties are not deducted from total expenditure (of the Government) while estimating Fiscal Deficit or Primary Deficit. So why

should the sale of assets be treated differently? In other words, payments on capital account are taken to add to a deficit while the acquisition of assets is not taken to reduce it. Extending this reasoning to sale of assets, it follows that the sale proceeds of assets should mean a reduction in a deficit, while the corresponding loss of assets should be ignored. The remaining items in the Table are self-explanatory. It only needs reiteration that repayments of loans by GOI do not appear in 'Expenditure on Capital Account' because the 'Borrowings' in capital receipts have already been reduced to 'net' of repayment figures.

However, it should be noted that 'Recoveries' of loans [item II (a)] from the debtors of GOI are included in item II (Capital Receipts). For this reason, item V (a) [Loans and Advances in Expenditure on Capital Account] includes gross (and not net) amounts of loans extended by the GOI to other parties like State Governments, Foreign Governments, Government Employees, etc.

The foregoing break-up of GOI budget enables us to define (and therefore estimate) a few concepts of deficit, namely, the following:

1.	Deficit on Revenue Account	(RD)
2.	Deficit on Capital Account	(CD)
3.	Budgetary Deficit	(BD)
4.	Fiscal Deficit	(FD) or (GFD)
5.	Net Fiscal Deficit	(NFD)
6.	Primary Deficit	(PD) or (GPD)
7.	NET Primary Deficit	(NPD)

Some additional concepts of deficit, which may be estimated independently, are

8.	Monetized Deficit	(MD)
9.	Public Sector Borrowing Requirements	(PSBR)
10.	Structural Deficit	(SD)
11.	Operational Deficit	(OD)

ELABORATION OF THE CONCEPTS

1. Deficit on Revenue Account (RD)

The excess of expenditure on revenue account over receipts on revenue account measures Revenue Deficit. From the Table, it would be

Item IV— Item I

Receipts on revenue account include both tax and non-tax revenue as also grants. Tax revenue is net of States share as also net of assignments of UT taxes to Local Bodies. Note that receipts of UT taxes normally exceeds the assignment of UT taxes to Local Bodies and the excess forms part of the Receipts on Revenue Account. Non tax revenue includes interest receipts, dividends, and profits, and non-tax revenue receipts of UTs. Grants include grants from abroad also.

Expenditure on revenue account includes both Plan and Non-Plan components. Thus the Plan components includes Central Plan and Central Assistance for State and UT Plans. Non-Plan expenditure includes interest payments, defence expenditure on revenue account, subsidies, debt relief to farmers, postal deficit, police, pensions, other general services, social services, economic services, non-Plan revenue grants to States and UTs, expenditure on UTs without legislature, and grants to foreign governments.

2. Deficit on Capital Account (CD)

The excess of capital disbursements over capital receipts measures the CD. Plan capital disbursements include those on Central Plan and Assistance for States and UTs. Non-Plan capital disbursements include defence expenditures on capital account; other non-Plan capital outlay; loans to public enterprises, States and UT governments, foreign governments and others; and non-Plan capital expenditure of UTs without Legislature. The item of capital receipts, already discussed above, includes 'recoveries' of loans extended by the Centre itself, but only 'net' receipts of loans raised by it. From the Table, we have

$$CD = \text{Item V} - \text{Item II}$$

Note that receipts on account of sale of 91-days treasury bills and drawing down of cash balances do not form a part of capital receipts. However, net receipts on account of sale of 182-days and 364-days treasury bills and sale of Government assets are included in capital receipts.

3. Budgetary Deficit (BD)

It is the sum total of RD and CD. From the Table,

$$BD = (IV - I) + (V - II) = (IV + V) - (I + II) = VI - III$$

BD is also exactly equal to item VII, that is, it is that portion of Government expenditure which is financed through the sale of treasury bills and drawing down of cash balances.

It should be noted that in economic literature and to a certain extent by international institutions, the term BUDGETARY DEFICIT is used to repre-

sent 'Fiscal Deficit' (FD) discussed below. FD is a wider concept while BD, as used in Indian official documents, is a narrower concept.

What is the justification for having a definition of BD which is at variance with its internationally accepted version? Officially, this justification is derived from the expected effect of government expenditure on aggregate demand and prices in the country. It is maintained that BD should represent a net addition to aggregate purchasing power in the hands of the economy and not just a transfer thereof from the private to the public sector. It is because borrowings taken from RBI (except through the sale of 91-days treasury bills) are excluded from BD even though such borrowings also add to the supply of money and credit in the economy.

4. Fiscal Deficit (FD)

This may also be called Gross Fiscal Deficit (GFD). It measures that portion of Government expenditure which is financed by borrowings and drawing down of cash balances. It should be noted that in India, borrowings are net amounts, (that is, gross borrowings less repayments). Similarly, loans extended by GOI are included on the expenditure side of capital account while 'recoveries' are included on the receipts side. Therefore, the amount of loans and advances by GOI is also reduced to a net figure. From the Table,

$$FD = [VI - \{I + II(a) + II(d)\}]$$
$$= II(b) + II(c) + VII$$

In other words, FD is (Total Expenditure less Revenue Receipts plus Recoveries plus Sale of Public Assets). It is also equal to the sum of three items, namely (i) borrowings, other than those through 91-days treasury bills, (ii) sale of public assets, and (iii) BD.

It is often stated that FD measures an addition to the liabilities of GOI (whether backed by acquisition of some assets or not). This, we should remember, is true only if the item 'drawing down of cash balances' is zero. Mostly, it is a small item and, therefore, by and large, the above-mentioned statement may be accepted in practical decision-making.

5. Net Fiscal Deficit (NFD)

This measure of deficit is obtained when FD is reduced by 'Loans and advances component [V(a) of 'Expenditure on Capital Account']. In other words, this measure considers the fact that some payments by the Government are not part of 'spending away' but for acquisition of assets. However, this reasoning is not carried to its logical conclusion. While assets acquired through giving loans to others are accounted for, those acquired through 'capital outlay' [a part of item V(b)] are ignored.

6. **Primary Deficit (PD)**

This measure is also referred to as Gross Primary Deficit (GPD). Measures of deficit described above (Except CD) include payments and receipts of interest. These transactions, however, reflect a consequence of past actions of the Government, namely, loans taken and given in years prior to the one under consideration. Exclusion of interest transactions would, therefore, enable us to see the way the Government is currently conducting its financial affairs. According, PD is defined as

FD less net interest payments, (that is, less interest payments plus interest receipts), so that

$$PD = FD - [IV(a) - I(b)(i)]$$
$$= FD - IV(a) + I(b)(i) \quad (a)$$

However, in GOI budgetary documents, interest receipts are ignored so as to get a smaller measure of PD. That is,

$$PD = FD - IV(a) \quad (b)$$

7. **Net Primary Deficit (NPD)**

This measure of deficit is obtained by subtracting 'Loans and Advances' (Item V(a)) from Net Fiscal Deficit. It is also equal to FD less interest payments plus interest receipts less loans and advances. Thus

$$NPD = FD - IV(a) + I(b)(i) - V(a) \quad (a)$$
and
$$NPD = FD - IV(a) - V(a) \quad (b)$$

This brings us to those concepts of deficit which cannot be estimated from the information given in the Table and have to be made available by the Government directly.

8. **Monetized Deficit (MD)**

It is defined as increase in net RBI credit to the Central Government. The rationale for this measure of deficit flows from the inflationary impact which a budgetary deficit exerts on the economy. Our Budgetary Deficit (BD) discussed above cannot meet this test. The Chakravarty Committee recommended that in addition to the existing measure of BD (namely, borrowings through 91 days treasury bills from the RBI plus drawing down of cash balances), it should include all forms of borrowings from the RBI by the Government. Since borrowings from RBI directly add to money supply, therefore, this measure is termed Monetised Deficit. It is obvious that MD is

only a part of FD. Also it should be noted that even MD is not a perfect measure of the inflationary impact of the budget. Loans from banking sector also add to the liquidity and inflationary forces in the economy.

9. **Public Sector Borrowing Requirement (PSBR)**

It may be termed consolidated Public Sector Deficit, and represents net claim on (that is net use of) the resources of the economy by the entire public sector. It is the most comprehensive measure of deficit and covers all the Government entities.

In brief, PSBR = (Total Expenditure - Revenue Receipts) for all Government entities. It also equals (New Borrowings less Repayments less Drawing Down of Cash Balances).

Note that expenditure includes wages of public employees, expenditure on goods and services, fixed capital formation, interest on debt, transfer payments and subsidies. However, it excludes amortization payments on government debt and accumulation of financial assets. Similarly, revenue includes taxes, fees, fines, rates, user charges, interest on public assets, transfers, operating surplus of public enterprises and sale of public assets. It, however, excludes drawing down of cash balances.

10. **Structural Deficit (SD)**

When the borrowing requirement of the public sector (PSBR) is adjusted for occasional or temporary measures for reducing deficit and raising resources, it is termed Structural Deficit (SD). It is a measure of deficit which is expected to persist unless long term corrective measures are adopted by the authorities. For example, if the government raises resources by 'sale of government assets' and through 'amnesty schemes', PSBR should be adjusted for these amounts to arrive at SD.

11. **Operational Deficit (OD)**

PSBR adjusted (that is reduced) for inflationary price rise gives us Operational Deficit (OD). Obviously, for arriving at OD, choice of an appropriate price index is of great relevance. However, it is very difficult to select an ideal price index. Another problem arises from the fact that while indirect taxes add to the revenue receipts of the Government, they are also inflationary in nature. Similarly, many PSUs included in the estimation of PSBR may resort to raising of user charges. This act would also simultaneously add to both the revenue of the Government sector and the inflationary forces at the same time.