Public Finance

Given the Finance Minister's assurance, on more than one occasion, that he would not cross the fiscal deficit to GDP target of 4.8% for the current fiscal, chances are he will prove his skeptics wrong and deliver on his promise. However, the quality of the fiscal adjustment is just as important as the numerical number. And here the unfortunate reality is that, as in the previous fiscal, the containment of the FD is likely to be done through the wrong kind of expenditure compression. Plan expenditure is likely to be squeezed, once again.

Meanwhile the Revenue Deficit (RD), which is the extent of the deficit that has gone to meet current rather than capital expenditure, has already crossed the target for the entire year during the first nine months of the current fiscal, with the RD/GDP ratio touching 103.5% by November 2013

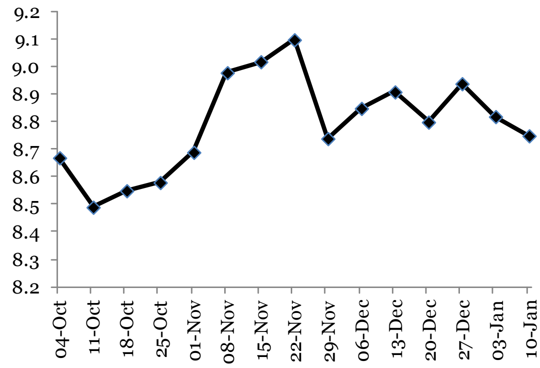
Trends in Revenue and Expenditure

Gross direct tax collections during April-December of the current fiscal are up 12.33 % at Rs.4,81,914 crore as against Rs.4,29,023 crore in the same period last year. While gross collections of corporate taxes have shown an increase of 9.35% and stood at Rs.3,10,126 crore as against Rs. 2,83,605 crore during the same period in last year, collection of personal income tax is up 18.53 % and stood at Rs.1,67,589 crore as against Rs. 1,41,385 crore during the same period in last year. Net direct tax collections are up 12.53% at Rs. 4,15,328 crore, compared to Rs. 3,69,067 crore in the same period in the last fiscal.

Reflecting subdued activity in the stock market, Securities Transaction Tax (STT) collections for the period stand at Rs. 3427 crore, a growth of 4.04 %. However, wealth tax collection posted a growth of 11.92% and stood at Rs. 742 crore as against Rs. 663 crore during the same period in last year.

Overall, tax collections are way below the budget estimates, thanks to the slowdown in economic growth and in the case of taxes like the STT, the decline in interest in stock market investment, especially from retail investors. Meanwhile as expenses mount, the government's fiscal deficit/ GDP ratio for the period to November 2013 has already touched 94% of the target of Rs 5.42 lakh crore for the year.

Figure PF.1: 10 Year G-Sec Yield



Fiscal Deficit

Faced with the very real prospect of breaching the fiscal deficit target of 4.8% of GDP for 2013-14, a target the finance minister has pledged to abide by, the finance ministry is seeking to make good the revenue loss from all possible avenues. Thus, public sector undertakings like Coal India Ltd have been nudged into declaring a special dividend way above that declared last year (Rs 29 per share as against Rs 14 per share last year). In the process the exchequer will garner as much as Rs 16, 489 crore by way of dividend; which along with the dividend distribution tax will fetch the government a handsome some of about Rs 19,600 crore. Other PSUs are not expected to escape – they will all be 'commanded' to pitch in to bridge the fiscal deficit, despite the obvious opportunity cost, in terms of deferment of sorely-needed investment in expanding their own operations.

Plans are also afoot to offload the government's stake in various profitable companies such as Axis bank, ITC, L &T that are presently held through SUUTI (Specified undertaking of Unit Trust of India) that was carved out of UTI, post the US-64 fiasco. SUUTI's holding, in these three companies (23.58 % in Axis Bank, 11.54 % in ITC and 8.27 % in L&T) is presently (January 2014) valued at approximately Rs 48,000 crore and will more than compensate for the shortfall in government's disinvestment target for the year (Rs 40,000).

Spectrum auction is another channel that is expected to fetch the government some money. As of now eight telecom companies are in the fray. The auction is not expected to fetch as much money as in the earlier rounds, thanks to the reduction in reserve price and the fact that a number of licences are set to expire this year. However, it is expected that the auction will succeed in garnering the Rs 11, 343 crore estimated in the Budget from spectrum sale.

There are also unconfirmed news reports of how government might resort to financial jugglery (deferring payment for expenses incurred this fiscal to the next) in order to meet the FD/GDP target. Some amount of jugglery has, perhaps, become a feature of our Budget exercises (recall the infamous off-budget items like oil receivables of the past). But the danger of window-dressing government fiscal numbers cannot be over-stated, as the Greeks will readily testify.

The importance of abiding by the 'Red line' on fiscal deficit is not in doubt, particularly since rating agencies have made no bones about the importance they attach to India being able to stick to the Budget number. However, the manner and the means are just as important as the end. It is unlikely rating agencies or informed observers will be taken in by adherence to the deficit number that is only on paper but masks underlying fiscal distress.

The quality of the fiscal adjustment, moreover, is just as important as the numerical number and here the unfortunate reality is that, as in the previous fiscal, the containment of the FD has been done through the wrong kind of expenditure compression. Thus the Revenue Deficit (RD), which is the extent of the deficit that has gone to meet current rather than capital expenditure, has already crossed the target for the entire year during the first nine months of the current fiscal, with the RD/GDP ratio touching 103% by November 2013.

Admittedly, government expenses tend to front-ended while revenues tend to be back-ended. So there is the hope that tax collections will pick up and the revenue deficit will be reined in. But for now the outlook is bleak, especially if one looks at the primary deficit (deficit excluding interest payments). This reached an incredible 172% of the target for the year by November 2013.

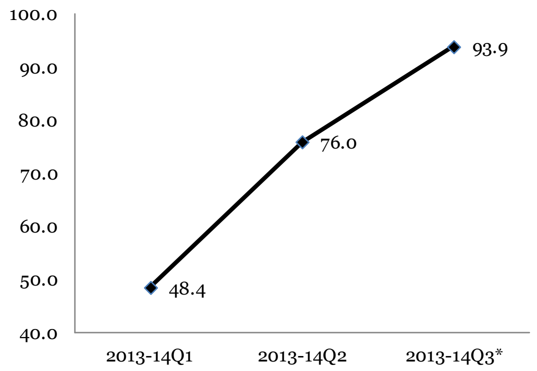
While the government might be able to adhere to the fiscal deficit to GDP target for the year by cutting back on plan expenditure and possibly, some financial jugglery, the quality of the adjustment leaves much to be desired.

Bond yields

Bond yields have corrected from the highs witnessed in the opening days of the third quarter of fiscal 2013-14. Government's decision to postpone its Rs15,000 crore bond issue mid-January also kept yield in checks. On 15 January, yields on 10 year bonds were down to 8.61 % in intra-day trade, the lowest since October 2013. The RBI's decision to go in for an OMO (open market operation) purchase of Rs 10,000 crore on 22 January 2014 also helped contain yields.

Better inflation data, both CPI and WPI, have led to the expectation that the RBI will continue with its 'pause mode' as far as policy rates are concerned. This, expectation was however, belied on 28th January 2014 when the RBI opted to hike the repo rate by 25 basis points to 8 % nonetheless the expectation of lower supply on account of government trying to keep within its fiscal deficit target, is expected to keep bond yields soft.

Figure PF.2: Fiscal deficit



The RBI had earlier announced a debt switch programme to the tune of Rs 50,000 crore under which the central bank would try to buy short-dated securities and issue long-dated ones in a bid to increase the maturity of government's debt. However there are reports that this too, might be deferred to the next fiscal

The government's decision to go in for a Vote-on-account on 17 February in view of the impending general elections in May 2014 means activity in the bond market is likely to be confined to the short end, pending clarity both on the composition of the new government and the borrowing progamme for the full fiscal 2014-15. Meanwhile the shift in the maturity profile of government debt, with government opting for issue of more short-term paper in the immediate aftermath of the financial crisis has meant a sharp increase in repayments with debt redemptions in the range of Rs 150,000 – 250,000 crore due every year from 2014-15. The Reserve Bank of India's Financial Stability Report released in December 2013, warns that redemption pressure could increase significantly from 2014-15 – 2019-20

Table PF.1: Union Government Accounts at a Glance

Item	Budget Estimates 2012-13	Revised Estimates 2012-13	Budget Estimates 2013-14	Actuals upto Nov 2013	% of Actual to Budget estimates
Rev Receipts	935,685	871,828	1,056,331	502,691	47.6
Total receipts	977,335	909,901	1,122,799	511,638	45.6
Total expenditure	1,490,925	1,430,825	1,665,297	1,021,195	61.3
Fiscal deficit	513,590	520,925	542,499	509,557	93.9
Revenue deficit	350,424	391,245	379,838	393,109	103.5
Primary deficit	193,831	204,251	171,814	295,123	171.8

Source: Based on data from Controller General of Accounts, Ministry of Finance