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Opinion: India's Fiscal deficit – a concern

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Irrespective of what some experts might want us to believe, India's economic growth this year is unlikely to breach the 6 per cent mark in real terms. An analysis of the GDP growth number during the previous two quarters viz the last quarter of 2008-09 and the first quarter of 2009-10 clearly revealed that with domestic demand stagnating, it was the high level of government expenditure that saved India the blushes. Added to that was the decent performance by the agricultural sector. However, with monsoon having failed, leading to severe droughts in a large number of states (especially up North) and floods in a few states (down South), the spring season (or the khariff) crop has been badly affected. For the next two quarters, therefore, contribution of agriculture is ruled out of the equation.

Going forward, the bigger question is whether industry can shoulder the burden. It's quite possible that it might not. The Index of Industrial Production (IIP), which started tapering off from August 2008, has shown signs of a rebound during June, July and August this year. But sustainability remains a question. The increase in production has a lot to do with demand generated through a substantial increase in government spending in the rural segment and the huge arrear payment received by the government employees in keeping up with the recommendation made by the 6th Pay Commission. This also coincided with the inventory built up that was taking place keeping in mind the likely surge in demand for the forthcoming festive season in India. However, it is quite likely that the tailwind is dying down as is evident from the fall in collection of excise duty data in September. It is quite likely, therefore, that the September IIP number would look anaemic.

Even the corporate results leave a lot to be desired. During the last two quarters, while the non financial companies have, on an average, been able to show improved profitability (mainly due to stringent cost cutting measures incorporated by them, falling commodity prices and interest rates), their revenue growth has virtually stagnated. This clearly indicates the domestic demand is yet to take root. Add to this the likely impact of plummeting rural demand (on the back of disastrous monsoon) going forward (remember the rural areas account for nearly 65 per cent of India population) and things do not look rosy indeed for the next couple of quarters at least.

In this scenario, how would India's fiscal deficit scenario look like? Quite uncomfortable, I am afraid what with to revenue collection likely to be hit.

Till September, the Apr-Sep'09 excise tax collection figure was down by about 25 per cent as compared to the same period the previous year. Agreed, as part of the stimulus package, the government announced reduction in duties for various commodities and this is also reflected in their budgeted collection of excise duty for 2009-10, which was assumed to be lower than the previous year by about

1.75 per cent. Nevertheless, the surge in August collection (around 23 per cent) as compared to July'09 was a harbinger of hope. This was in line with the IIP growth of above 10 per cent. However, the latest data for the month of September dashed the hope. The September number was down by about 5 per cent as compared to August'09 and the Apr-Sep'09 collection is now down by around 21 per cent. This means that the excise collection has to grow by about 19 per cent every month if we are to match the targeted collection.

Same is the issue with corporate tax collection. Corporate tax accounts for about 35 per cent of total tax collection and the government expects the corporate tax revenue to jump by 15.64 per cent in this fiscal year. However, for the period Apr-Aug'09, corporate tax has increased by less than 8 per cent. This means that for the next seven month, corporate tax has to increase by more than 16 per cent month-on-month to achieve the target. Again a very tall order.

Overall, tax revenue collected during the first six months of this fiscal is about 39 per cent of the one budgeted for the full year. During the same period last year, the collection was close to 40 per cent of what was budgeted and the final collection figure showed a shortfall of close 9 per cent of the budgeted. The situation is unlikely to be different this time.

Add to this the huge spending requirement for the rural sector following the poor monsoon and there is every likelihood of the overall central fiscal deficit exceeding the 7 per cent mark.

Then there's increasing below the line expenditure to contend with. Available indication suggests that India's food subsidy bill will top Rs.600 billion this year, which is at least 15 per cent more than what was budgeted for at Rs.521 billion.

Overall, if we add the expenditures on various heads of subsidies and the deficit at the state government levels, India total fiscal deficit for the current fiscal year can touch a mind boggling 13 per cent of GDP.

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