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A Reality Check on India's Fiscal Deficit

By Kunal Kumar Kundu

Dhiraj Singh/Bloomberg News
In 2011-12, the fiscal deficit was less than 6% of the GDP in India.

One set of figures largely ignored after the federal budget presentation last week was the Indian government's monthly accounts.

The data showed that India's fiscal deficit in the first 10 months of the year (April-January) rose to 90.7% of the budgeted amount from 78.8% in the first nine months. An important reason for the sharp rise was that the government paid a share of its oil subsidy for this year.

The amount paid was 300 billion rupees ($5.5 billion.) Earlier in the year, the government had paid 385 billion rupees as oil subsidy, but that was for the previous year. Deferring payment was a tactic to leave a fiscal deficit of less than 6% of gross domestic product in 2011-12.

For this year, the government expects the fiscal deficit to be 5.2% of GDP. But there are reasons to believe the deficit will be higher.

First, Finance Minister P. Chidambaram's revised estimate of petroleum subsidy for the year stands at 969 billion rupees. This includes the 385 billion rupees that was paid out for last year. So the finance minister is essentially accounting for only 584 billion rupees.

However, according to the Petroleum Ministry, the oil subsidy for the first nine months of 2012-13 (April-December) should be 1.25 trillion rupees. The figure is expected to be about 1.64 trillion rupees for the full fiscal year.

That would put the government's share of the subsidy at around 980 billion rupees, assuming it forces oil companies to bear 40% of the total oil subsidy burden. This year, the government isn't accounting for 396 billion rupees of oil subsidy.

Had it done so, the fiscal deficit would be 5.6% of GDP rather than the 5.2% forecast. Assuming, like last year, that the shortfall will be paid out during 2013-14, the government will be left with only 254 billion rupees as subsidy for 2013-14 (the budgeted oil subsidy for 2013-14 is only 650 billion rupees.)

India's fiscal deficit target for 2013-14 is 4.8% of GDP, as drawn up by the finance minister in a five-year roadmap released in October.

But the assumptions for containing the fiscal deficit are quite flawed.

Mr. Chidambaram said he expects nominal GDP to grow 13.4% next fiscal year. This implies that the government expects real GDP to grow 6.7%, assuming average inflation of 6.7%.

For an economy that has barely grown 5% this year, the growth expectation seems a stretch. The forecast that tax revenue will grow 19.1% is also unrealistic.

On the other hand, subsidy expenses appear to have been understated. In addition to the lower oil subsidy allocation (given the new trend of deferring payment), the allocation for food subsidy is questionable.

For 2013-14, the allocation increased by a mere 50 billion rupees to 900 billion rupees. Given that food security is one of the most important planks for the government ahead of elections, this seems to be grossly underfunded.

As polls approach, the government could raise food subsidy expenditure. There's also a possibility it will reverse its decision for a graded increase in the price of diesel. Such moves would lead to a spurt in subsidy expenses.

As such, the fiscal deficit next year could very well be in the region of 5.2%-5.5% of GDP rather than the 4.8% hoped for.

The author is an economist based in New Delhi. These are his personal views.