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India's Damaged Deficit Prospects

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Oil subsidies are among the many factors contributing to India's fiscal deficit.

Earlier this week, India's Controller General of Accounts released the government's latest statement of accounts of the Indian government.

It showed that the country's cumulative fiscal deficit for the first eight months of the year that began April 1 was 4.13 trillion rupees, which is 80.4% of the amount initially envisaged in the budget for the 12 months that end March 31.

This is a clear danger signal for the government as it struggles to meet its revenue target while expenditure soars. The lukewarm response to the government's effort at selling stakes in state-owned companies and an even worse response to an auction of second-generation mobile-phone spectrum have compounded the government's woes.

The government has been talking a lot about its efforts at fiscal consolidation. Unfortunately, it has been unable to walk the talk (at times due to its own lack of desire and at times due to opposition from political rivals).

Not surprisingly, the targeted fiscal deficit has already increased from 5.1% of gross domestic product at budget time early last year to 5.3%. The government in fact will be lucky to contain it under 6%.

The government's primary deficit (the fiscal deficit less interest payments) during the first eight months is already 119% of what was budgeted for the financial year ending March 31. This accounted for roughly 55% of the total fiscal deficit. Which means that roughly 45% of the fiscal deficit is accounted for by interest expenses from government borrowing.

Clearly, continued and higher borrowing requirements due to overshooting the deficit target are taking a sharp toll on the government's finances, as is India's relatively high-interest rate regime. Thus the government continues to clamor for a rate cut (even though inflation remains robust) to ease pressure on the deficit.

The other big pressure, of course, comes from subsidies, especially oil subsidies. According to the Petroleum Planning & Analysis Cell, the difference between the cost of selling oil products and the amount received from consumers by the country's three oil marketing companies – Indian Oil Corporation Ltd., Bharat Petroleum Corporation Ltd., and Hindustan Petroleum Corporation Ltd. — during the year ended March 31 was 1.4 trillion rupees.

Of this, the government forced the upstream oil companies – Oil & Natural Gas Corporation Ltd, Oil India Ltd. and Gas Authority of India Ltd.— to bear close to 40% of the under-recovery, or the difference between the cost of production and the sale price during the year ended March 31, 2012.

On the other hand, the government's share of shouldering that under-recovery was pegged at 835 billion rupees. However, out of this, the government funded only 450 billion rupees of that shortfall last fiscal year and the balance of 385 billion rupees was paid out only this year.

The problem is, during FY13, the government has made a total provision of only 436 billion rupees for oil subsidies, according to the budget.

Hence, out of the total budget provision for this year, the government used up close to 90% of the budgeted amount to pay for the previous year's subsidy.

Essentially, the government resorted to borrowing from the future to mange current expenditure.

Thus, for this year, the government is left with a budgeted oil subsidy of a mere 50 billion rupees. During the first six months of the fiscal year, however, total under-recovery stood at 856 billion rupees – virtually double the target for the full year.

On Dec. 27, India's oil ministry shared its plans to raise the price of diesel and kerosene by 10 rupees a liter over a period of 10 months and two years, respectively. This might help, but also may face stiff political opposition as its impact is felt chiefly by the poor.

Even in the most unlikely scenario of the proposal being accepted in its entirety, the current year's fiscal situation seems to have already been damaged beyond repair.

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