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Fiscal adjustment: Why and for Whom

The macro-economic stabilisation programme embodied in the last three budgets has been regressive in its impact, with the burden of adjustment being borne by the poor rather than the rich, argues ***Deepak Nayyar***

THE macro-economic disequilibrium which plunged the Indian economy into a crisis situation in 1990-91 was attributable to mounting imbalances in the fiscal system throughout the 1980s. In these circumstances, stabilisation was imperative. Fiscal adjustment, which sought to reduce the wide gap between the income and expenditure of the government, constituted the core of the macro-economic stabilisation programme.

We have, since then, experienced three years of adjustment. It is now time for an evaluation. In my judgement, the quality of the fiscal adjustment leaves much to be desired. There are three reasons underlying my concern: (a) it cannot provide a sustainable solution to the fiscal crisis; (b) it is likely to constrain economic growth; and (c) it is distributing the burden of adjustment in an unequal manner. Consider each proposition in turn.

First, the fiscal adjustment embodied in the budgets of the Central government has relied on a surplus in the capital account to finance a deficit on the revenue account. This is because the focus of adjustment is on the fiscal deficit rather than the revenue deficit of the government. The gross fiscal deficit of the Central government was reduced by more than two percentage points of GDP in one year : from 8.4 per cent of GDP in 1990-91 to 6.2 per cent in 1991-92. This fiscal deficit was cut further to 5.7 per cent of GDP in 1992-93, but is likely to be 6.2 per cent, or more, in 1993-94. It would seem that we have just about managed to stay put at the level of adjustment attained in the very first year.

REVENUE DEFICIT: But the real problem is that the revenue deficit of the government at 2.7 per cent of GDP in both 1991-92 and 1992-93 is the same as it was in the second half of the 1980s. Given the revenue shortfalls and expenditure overruns during the current financial year, it is almost certain that the revenue deficit would be at least 2.7 per cent of GDP in 1993-94. The government has therefore continued to borrow as much as 2.7 per cent of GDP every year to finance its consumption expenditure despite the so- called adjustment over the past three years.

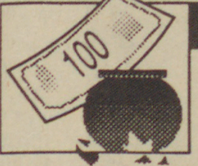
In an ideal world, there should be a revenue surplus large enough to finance capital expenditure on defence and in the social sectors, where there are no tangible returns, so that borrowing is used only to finance expenditure that yields a future income flow to the exchequer. The reality in India, despite fiscal adjustment, is the opposite.

Second, the process of fiscal adjustment has created a massive squeeze on public investment. In the Union budgets for 1991-92, 1992-93 and 1993-94, the period of adjustment, the provision for capital expenditure in the Central plan and in Central plan assistance for the states - perhaps the best aggregate measure of resources allocated to finance public investment - remained almost unchanged in nominal terms, at about the same level as in 1990-91, and declined in real terms.

RESOURCE CRUNCH: The resource crunch was even more acute for public investment in infrastructure. Budget support for the key infra- structure sectors - energy, transport and communications - registered a significant decline not only as a proportion of total Central government expenditure but also in nominal terms. But that was not all. It is worth noting that, between 1989-90 and 1992-93, such budget support for infrastructure dropped from 1.75 per cent of GDP to 0.95 per cent of GDP and contracted by as much as 40 per cent in real terms from Rs 3900 crore to Rs 2350 crore at constant 1980-81 prices. These cuts in public investment, particularly those on infrastructure, are bound to constrain the supply response of the economy in the medium term. The problem may be accentuated because evidence suggests that public investment "crowds-in" rather than "crowds-out" private investment.

Third, the distribution of the burden of adjustment so far has been unequal. This is apparent from the trends in expenditure on the social sectors and on poverty alleviation programmes. The allocations for the social sectors - education, health, family welfare, water supply, sanitation, housing, urban development, social welfare, welfare of the underprivileged, nutrition, and labour welfare stagnated in real terms, in the range of Rs 2400 crore at 1980-81 prices, and declined from a little more than 1 per cent of GDP to a little less than 1 per cent of GDP. But expenditure on poverty alleviation programmes, at constant prices or as a proportion of GDP, in both 1991-92 and 1992-93, was lower than it was in 1989-90 and 1990-91 (see table). It need hardly be stressed that, in a period of stabilisation and adjustment, resources provided for social services and for the poor should be increased, rather than decreased or just maintained, in real terms. Otherwise, the phrase 'adjustment with a human face' is no more than rhetoric or illusion.

I recognise that it is not entirely appropriate to consider Central government expenditure on the social sectors and on poverty alleviation programmes in isolation, because a large proportion of the expenditure on social services and some part of the expenditure on poverty programmes is



GOVT. SPENDING ON POVERTY PROGRAMMES

	1989-90	1990 - 91	1991 - 92	1992 - 93
As percentage of GDP	0.61	0.50	0.37	0.45
At constant 1980-81 prices (Rs. crore)	1361	1189	894	1134

PERFORMANCE INDICATORS

	1989-90	1990-91	1991-92	1992-93
Integrated Rural Development Programme: Families assisted (million)	3.35	2.90	2.54	2.07
Jawahar Rozgar Yojana Employment generated (million man-days)	864.4	874.6	808.1	778.3

TOI (D) GRAPHICS / SADHANA MOOLCHANDANI

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financed by the state governments. But if we wish to consider the impact of fiscal adjustment during the past three years, a focus on Central government expenditure is unavoidable. What is more, the above conclusion is borne out by the evidence available on performance indicators in terms of quantitative achievements in the two major poverty alleviation programmes for rural India (see table).

IRDP ASSISTANCE: The number of families assisted under the Integrated Rural Development Programme, which seeks to promote self-employment among the rural poor by providing productive assets or inputs through a mix of subsidies and bank credit, declined steadily from 3.4 million in 1989-90 to 2 million in 1992-93. The employment generated under the Jawahar Rozgar Yojana, which seeks to create employment for the rural poor on works that are meant to create productive assets in the rural sector, also declined from 864 million mandays in 1989-90 to 778 million mandays in 1992-93. In both, the decline was pronounced during the period of adjustment whether 1991-92 or 1992-93. Clearly, the real value of resources made available for poverty alleviation programmes diminished as a consequence of fiscal adjustment in the process of stabilisation.

It is my belief that fiscal adjustment should have come from a more appropriate mix of expenditure-cuts and revenue-raising instead of relying exclusively on the former. In a period when we are imposing a substantial burden on the poor through expenditure adjustment, the equity principle demands that the rich and the better-off share in this burden through their contribution to direct taxes. For this, it is absolutely essential to broaden the base for direct taxes so that a larger number of people are brought into the tax net, and to deepen the structure of direct taxation by increasing the average rates of tax. The adjustment so far and the tax reform on the anvil appear to be moving in the opposite direction.

In caricature form, the underlying philosophy can be summed up as comfort for the rich and hardship for the poor. It is important to stress that such patterns of adjustment are nothing new for they have been reproduced time after time in developing countries which embarked on stabilisation and adjustment. Experience from elsewhere suggests that the squeeze on supply responses and the burden on the poor persists in the medium term.

In sum, it seems that the fiscal adjustment embodied in the past three budgets has lost sight of why the adjustment was necessary in the first place. The budget makers have been concerned with form rather than substance and quantity rather than quality. What is more, the adjustment has been regressive in its impact. The rich, who derived much of the benefit from the profligacy of the 1980s, when the government and the country lived beyond their means, have been spared the burden of adjustment, while the cost is borne by the poor.

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