Unit 4 (sec)

DEFICITS

REVENUE DEFICIT- Revenue Deficit is the excess of its total revenue expenditure to its total revenue receipts. Revenue Deficit is only related to revenue expenditure and revenue receipts of the government. The difference between total revenue expenditure to the total revenue receipts is Revenue Deficit. It includes only those transactions of the government that affect the current income and expenditure of the government. It signifies that the govt is living beyond its means to conduct even the day to day operations. A revenue deficit indicates that the government doesn't have sufficient revenue for the normal functioning of the government departments. In other words when the government starts spending more than it earns it results in Revenue Deficit.

It is calculated as follows :-

Revenue deficit = revenue exp – revenue reciepts

Remedial measures:

To cover up the deficit the govt can take up the following steps:-

1. The government may resort to borrowing from other countries or international financial institutions (like World Bank or IMF).
2. The govt may raise funds by disinvestment i.e by selling its assets.
3. The govt may borrow from the central bank by issuing new currencies.
4. In the long run the government may seek to increase the tax rates or it may choose to expand the tax base of the economy.
5. Lastly the government can also choose to increase its income from non tax sources i.e by increasing the rates of fines, fees etc.

   In addition to these measures to raise funds, the government shall also consider to restrict its expenditures. Major part of the govt expenditure is committed expenditure and hence can't be reduced. So the govt has to reduce its productive capital expenditure or welfare expenditure.

Disadvantages of Revenue Deficit

A revenue deficit could adversely affect the economy in the following ways :-

1. Financing the deficit through borrowing from other countries or international financial institution would build up a pile of debt and interest liabilities. A persistent revenue deficit situation may lead to fall in the credit rating of a government. That's because consistently running a deficit could imply that a government is unable to meet its current and future recurring obligations.
2. Borrowing from central bank by issuing new currencies may create a problem for inflation in the economy which if not checked shall reflect itself as revenue deficits in the coming period.

3. Borrowing undertaken to finance the revenue deficit will increase interest burden on the future generation which will in turn increase revenue expenditure in future and give rise to the problem of revenue deficit for the next generations.
4. A reduction in the productive and welfare oriented expenditure by the government to tackle the problem of revenue deficit would bring down the level of growth and welfare of the country.

<u>Fiscal deficit</u>

It is equal to the excess of total expenditure (capital and revenue) over the sum of revenue and capital receipts excluding borrowing.

Fiscal deficit = total exp – revenue receipts- non debt creating capital receipt.

Here the non debt creating capital receipt are those receipts which are not borrowing and therefore, do not give rise to debt. Recoveries of loan and receipts from disinvestments are example of non debt creating capital receipts. The deficit thus will have to be financed through borrowing. Therefore fiscal deficit shows the net dependence of a nation upon borrowing (net borrowing at home + borrowing from RBI + borrowing from abroad) to meet their budget expenditure.

Thus fiscal deficit = net borrowing at home + borrowing from RBI + borrowing from abroad.

<u>Financing the deficit</u>

A deficit in the govt budget may be financed through the following ways :-

1. **Monetary expansion**:- Under this method the govt seeks credit from the central bank by selling treasury bills to the later. In return the central bank issues cash to the govt by printing new currencies. The govt uses these funds to cover the deficit.
2. **Borrowing**:- The fiscal deficit can be funded by borrowing from the domestic source (i.e public and commercial banks) and the external sources (foreign nations, world bank, IMF). However borrowing from public is considered better than borrowing from external source as it does not increase the supply of money in the industry which is the cause of inflation.
3. **Disinvestment**:- Under this method govt seeks to selling its assets or partial share of its PSUs. The fund so collected by the selling of govt assets are used to cover the deficit..
4. **Fiscal discipline**:- Under this method govt tries to cover its deficits by reducing public expenditure or by increasing its tax rate or tax base.

<u>Implication or effect of fiscal defict</u>

1. **Vicious circle of borrowing** :- the payment of loan interest increases revenue expenditure which in turn causes higher revenue deficit. The increased revenue deficit may further lead to more borrowings and more interest payments. Thus a vicious circle of borrowing may be created.
2. **Inflationary pressure :-** the borrowing of govt from the central bank leads to printing of new currencies which in turn leads to a increase in the supply of money. Such increase in

money supply may soon cause the AD of the nation to rise and create a inflationary pressure in the market.

3. **Increase foreign dependence:-** when the govt seeks to cover its deficit by borrowing from the external sector, then it may led to the loss of economics and political sovereignty of the nation. In other words the borrowing from foreign nations allows them to interfere in the economic and political matters of domestic nation.
4. **Economic burden on the future generations**:- Borrowing implies build up of economic burden for the future generations. It is for the future generations to repay the loans as well as their interest liabilities.

   It should be noted that fiscal deficit is not always disadvantageous. Fiscal deficit is useful to an economy if it creates new capital assets and raises the productive capacity of the economy. It is advantageous if it is used to give desired direction to the economy.

5. **Reduction in growth rate:-** In order to deal with the problem of fiscal deficit the govt needs to reduce the amount of public expenditure. Such reduction in public expenditure implies a fall in the govt investment in major developmental projects which shall be followed by a fall in the growth rate in the upcoming years.

Primary deficit

It is defined as fiscal deficit minus interest payments.

Primary deficit = fiscal deficit – interest payment

It indicates the real burden of the govt finance as it excludes the interest burden on loan taken in the past. High primary deficit implies fiscal irresponsibility of the government and a low primary deficit implies that the govt is borrowing largely to make previous interest payments. So a higher primary deficit implies that the govt is using a larger component of its fiscal deficit to finance the current year's exp rather than previous years' interest payments.