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Fiscal Deficit - UPSC Notes

Fiscal deficit is an important term frequently used in business news and is relevant for the civil services exam. IAS aspirants must be aware of the meaning of fiscal deficit and also the difference between fiscal deficit and revenue deficit, and other concepts for the UPSC economy segment.

What is Fiscal Deficit?

Fiscal deficit is the difference between the government's total expenditure and its total receipts (excluding borrowing). A fiscal deficit occurs when this expenditure exceeds the revenue generated.

- Fiscal deficit is when a government's total expenditures exceed the revenue that it generates (excluding money from borrowings).
- The deficit does not mean debt, which is an addition of annual deficits.

What is the Formula of Fiscal Deficit?

Fiscal Deficit = Total Expenditure (Revenue Expenditure + Capital Expenditure) – (Revenue Receipts + Recoveries of Loans + Other Capital Receipts (all Revenue and Capital Receipts except loans taken))

- Gross Fiscal Deficit (GFD) of the government is the surplus of its total expenditure, current and capital, as well as loans net of recovery, above revenue receipts (including external grants) and non-debt capital receipts.
- A fiscal deficit happens because of events like a major increase in capital expenditure or due to revenue deficit.
    - Capital expenditure is incurred to create long-term assets like buildings, factories, infrastructure development, etc.

- **Fiscal deficit serves as an indicator of how well the government is managing its finances.**

- A recurring high fiscal deficit implies that the government has been spending beyond its means.
- However, fiscal deficit is seen in almost every economy while fiscal surplus is quite rare. High fiscal deficit is not always a negative thing if the amount is utilised for constructing roads, airports, infrastructure, etc. since these will generate revenue in the long run.
- Fiscal Consolidation refers to the policies undertaken by governments (national and sub-national levels) to reduce their deficits and accumulation of debt stock. Read all about fiscal consolidation in the linked article.

Fiscal Deficit Calculation

Fiscal deficit is arrived at by calculating the difference between the total expenditures incurred by the government in a fiscal year and the total revenue obtained by it.

Fiscal deficit = Total Expenditure – Total Revenue (excluding the borrowings)

The fiscal deficit is usually expressed as a percentage of GDP.

Components of Fiscal Deficit

The two components of fiscal deficit are income and expenditure.

1. Income: the total income generated by the government can be divided into:
    1. Tax revenue: GST, customs duties, corporate tax, etc.
    2. Non-tax revenue: dividends and profits, interest receipts, etc.
2. Expenditure: this includes capital expenditure, revenue expenditure, grants for capital assets creation, interest payments, etc.

How is Fiscal Deficit Financed?

There are two sources to finance fiscal deficit. They are:

1. Borrowings: internally from a commercial bank, or from external sources like the IMF, other governments, etc.
2. Deficit financing (that is, printing new currency): borrowing funds from RBI against its securities (so, RBI prints new currency).

The government meets the fiscal deficit by borrowing so, it can be said that the total borrowing requirements of a government in a year is equal to the fiscal deficit of that year.

India's Fiscal Policy Framework

Here are some interesting facts about India's fiscal policy agenda:

- The Indian Constitution has provided directives for the formation of a Finance Commission (FC) every five years.
- This is to provide the basis for the assignment of some of the centre's revenues to the state governments and provide medium-term direction on fiscal matters, as taxing capacity of the states are not necessarily proportionate with their spending responsibilities.
- The Budget where the government shall put before the Parliament an account of its proposed taxing and spending provisions for legislative debate and approval is also an important part of fiscal policy.
- The Fiscal Responsibility and Budget Management Act (FRBMA) 2003 is an Act concerned with fiscal discipline.

Read more on the Fiscal Policy of India.

Difference between Fiscal Deficit and Revenue Deficit

Fiscal Deficit	**Revenue Deficit**
It is the excess of Budget Expenditure over Budget Receipt other than borrowings.	It is the excess of Revenue Expenditure over Revenue Receipts.
FD = Budget Expenditure - Budget Receipts (excluding borrowings)	RD = Revenue expenditure –Revenue receipts
It reflects the total government borrowings during a fiscal year.	It reflects the inefficiency of the government to reach its regular or recurring expenditure.