

Policy Space, Fiscal Space, and Financing for NREGA

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What is Fiscal Space?

- **The IMF's approach to fiscal space:**
 - » Fiscal space is *“room in a government's budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or the stability of the economy.”* (From Quarterly newsletter: [Finance and Development](#), IMF).
- UNDP's approach to fiscal space
 - » *“Fiscal space is the financing that is available to government as a result of concrete policy actions for enhancing resource mobilization, and the reforms necessary to secure the enabling governance, institutional and economic environment for these policy actions to be effective, for a specified set of development objectives.”* (Roy, Heuty and Letouze, 2007).

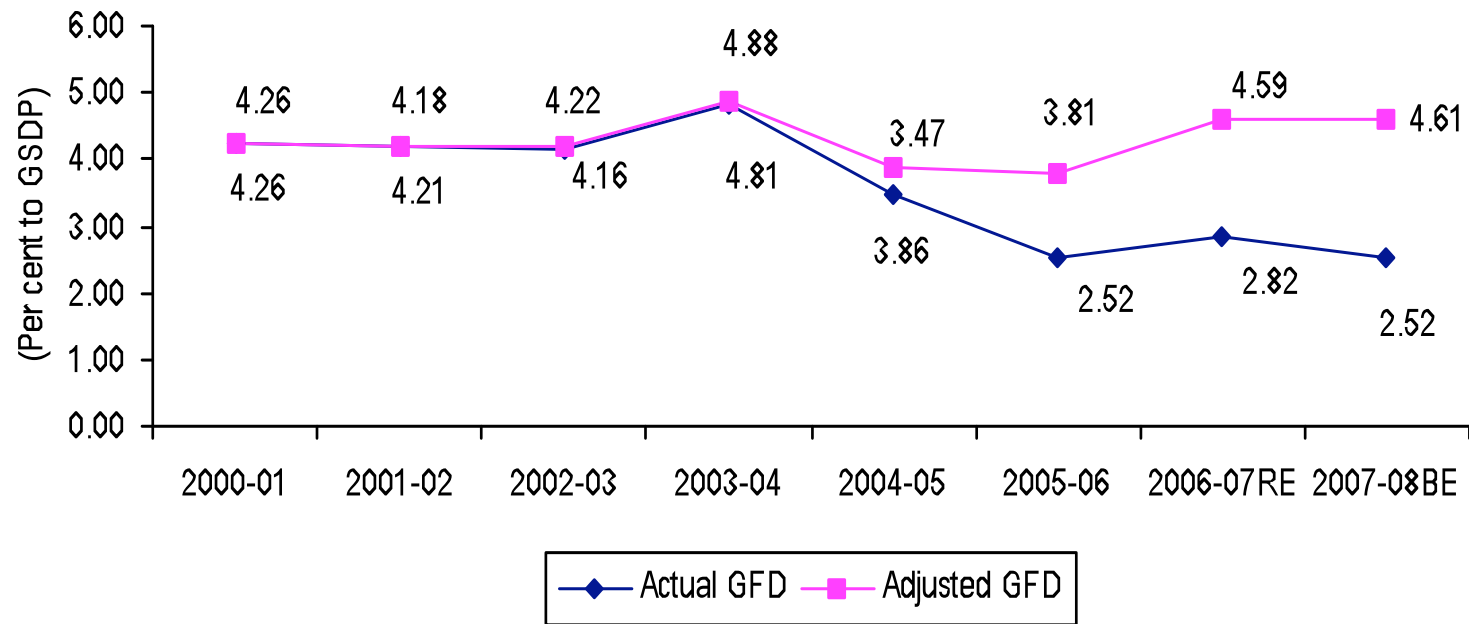
What are the differences in approach?

- In the IMF approach, fiscal solvency is the prime concern
 - » Implicit Assumption: Expanding expenditure should not result in fiscal unsustainability.
- UNDP Approach
 - » Achieving broader development outcome and its financing. Issue of resource mobilization becomes critical.
- Issues in resource mobilization
 - » Domestic resources: tax, non tax, domestic borrowing, privatization proceed of public sector (disinvestment)
 - » External finance
 - » Reprioritization of expenditure

What is the Indian fiscal scene?

- Beginning of Economic Reform
 - High combined fiscal and revenue deficits,
 - » Efforts to contain them by reducing discretionary development spending,
 - » Decline in capital expenditure for public investment
 - » Decline in social sector spending
- Introduction of rule based fiscal control
 - FRBM Act of the Union Government
 - » Numerical target of reducing fiscal deficit to 3 per cent of GDP by the end of 2008-09 and eliminate revenue deficit by 2008-09
 - » State level FRA introduced through the design of debt relief to the states by the Finance Commission
- Overall effect:
 - » Huge reduction in deficits of both centre and states by the end of 2007-08.
 - » Significant increase in tax to GDP ratio in recent years
 - » Increase in development spending
- What explains this improvement: Fiscal rule or the growth?
 - » This has happened in a period of high growth,
 - » Growth induced increase in revenues of both centre and states
 - » Soft interest rate regime

Figure 1: Quantifying the Effect of Interest Rate & Central Transfers on Fiscal Consolidation



Timing of NREGA

- Most appropriate:
 - » In a period of high economic growth, high tax buoyancy,
 - » Low fiscal imbalance,
 - » Enhanced fiscal space
- Policy Space
 - » Benefits of growth did not reach all. Urban centric growth.
 - » Issue of exclusion became critical. Needed to be done something for rural India.
 - » Huge opposition from fiscal conservatives
 - » But the Act was ultimately passed in Parliament in 2005
 - » Implemented initially in 200 districts, then to 330 and now extended to all the districts of the country (only in rural areas)
- Outcome
 - » Jobs provided: (45 million households), SCs(29.35), STs (25.36), women (47.86)

NREG Expenditure and Fiscal Space: Few Key Ratios

(In Per
cent)

| | 2006- 07 | 2007- 08 | 2008-09 BE | 2008-09 RE | 2009-10 BE |
|--|-------------|-------------|---------------|---------------|---------------|
| Rural Employment as % of Total Expenditure | 4.2 | 1.9 | 1.6 | 3.3 | 2.8 |
| NREG Exp. As % of Total Expenditure | 1.2 | 1.5 | 1.6 | 2.7 | 2.8 |
| NREG Exp. As % of Revenue Receipts | 1.6 | 1.9 | 2.0 | 4.4 | 4.1 |
| NREG Exp. As % of Fiscal Deficit | 6.1 | 10.0 | 10.8 | 9.2 | 9.0 |
| Fiscal Deficit as % of GDP | 3.44 | 2.69 | 2.46 | 6.02 | 5.53 |
| Revenue Receipts as % of GDP | 12.7 | 13.8 | 13.5 | 12.6 | 12.2 |

Source: Budget Documents, Government of India

How this crisis induced increase in deficit is viewed?

- General Consensus in government policy
 - » Come back to the pre-crisis level of fiscal deficit as early as possible, the “sustainable path”, the FRBM target
 - » Also it is recognized that government needs to spend more with slowdown in the economy
 - » But the good thing is no body is talking about reduction in NREG expenditure
 - » Policy space has expanded
- The bigger question
 - » Was NREGA used as an instrument of fiscal stimulus?
 - » Is there a space for extending the scope of the programme?

Nature of Fiscal Stimuli

- Revenue side Fiscal stimuli:
 - » Across the board cut of 4 per cent in the cenvat rate is expected to boost demand, apart from other measures to support export, housing, MSME, textile and infrastructure sector.
 - » Cut in excise duty and service tax by 2 per cent announced after the interim budget.
- Expenditure Side Fiscal stimuli
 - » An additional increase in plan expenditure to the tune of Rs. 200 billion
 - » Additional market borrowing to the tune of around Rs. 300 billion for capital expenditure and the third stimulus extended the continuation of enhanced borrowing limit for the year 2009-10.

What is the net effect on the fisc & possible outcome?

- An estimated fall in central tax revenues to the tune of Rs. 900 billion for 2008-09 (RE).
- This fall in central taxes would have huge contractionary effect at the state level due to the fall in central tax devolution to the states
- The sluggishness of states' own revenues hit by recession has further reduced the availability of resources.
- States budgets are on the path of fiscal contraction reflected in the decline in the growth of major expenditure components in the year 2009-10, vis-vis- 2008-09.
- The net effect is at aggregate level (taking centre and states together) there is a high possibility of fiscal contraction.
- The need of the hour is to suspend the FRA for the time being so that states are well equipped to counter the crisis induced effect in the local economy
- If fiscal space is not increased , this is bound to create further bottlenecks for both social and physical infrastructure, increase poverty and would hamper growth.

Economic Slowdown, EGS & Fiscal Space

- The policy space for EGS is huge as it has paid political dividend
 - » It was introduced when government was trying to follow the path of rule based fiscal control
 - » Now given the down turn when FRBM is not the priority, the policy space further enhances for the extension of the programme
- There is talk to extend it to urban areas
 - » As total allocation in NREGA is roughly 0.5 per cent of GDP (2008-09), one can safely assume the budgetary cost of extension for urban are would not be huge.
 - » Increase the number of days of employment in rural areas
- One of the small states in the north-eastern region of the country is planning to introduce EGS in urban areas on its own without central government support.
- The central allocation for NREGA has increased exponentially
 - » Between 2006-07 and 07-08, the increase is 46.52 per cent, between 2007-08 and 2008-09, it is 136.94 percent
- However, fund utilization ratio remains poor in many states, especially in poorer regions
- There are issues related to access
 - » Many do not know that it is a legal right
 - » We need to address the issue of “demand side vulnerability” much more effectively
 - » Capacity building at local level for effective implementation
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