

# Suggestion for major reduction in Fiscal Deficit



**Akhil Gupta**  
Vice Chairman  
Bharti Enterprises Ltd.

India like rest of the world is going through a difficult economic situation. This would be clear from the fact that we have high inflation, the Finance Ministry is indicating twin increase in deficits - fiscal and current account deficit; despite the rate increase there is still large liquidity in the banking system which along with steep (though expected) devaluation of Indian Rupee could result in more inflation and that with rising interest rate, the government

borrowings are becoming very expensive. These all need to be tackled urgently.

The seriousness of these should also be seen in the context of the Union Budget for the year 2022-23 wherein the fiscal deficit at 16.61 Lakh Crores representing 6.4% of GDP was already much higher than the desired levels. To fund the deficit, RBI announced the plan to raise 14.95 Lakh Crores through market securities during this year with a specific calendar to raise 8.45 Lakh Crores in the first half of FY 2022-23. These indeed are very sizeable amounts which inevitably will increase the interest rate of such borrowings.

It is obvious that to tackle this situation, the government revenue needs to go up with corresponding decrease in market borrowings. The question is how? Given below is a suggestion which could make these two objectives achievable.

We are all aware that government has receivables from various industries by way of license fee, revenue share and levies payable by different concessionaires over a period of license/concessions granted. The examples of such industries where the government would have receivables as on date as well as future receivables in terms of the concession agreements are Road Transport, Shipping, Telecom, Mining, Oilfields, Airports, etc.

For Telecom, it is public knowledge that the net present value of dues in respect of spectrum and past AGR dues are approx. 2.50 Lakh Crores which are to be received by the government in yearly instalments over the next 10-12 years with interest. This amount is expected to increase post 5G spectrum auctions scheduled later in the year. There will be similar receivables over a period of time for other industries and one can safely assume that the overall receivables by the government would at least be in the vicinity of 5-6 Lakh Crores on this account as on date.

In addition to these, there will be ongoing receivables from various industries under agreed concession agreements. The overall net present value of such estimates of future receivables can be safely assumed to be another 5-6 Lakh Crores.

The suggestion is for the Banks to take over the current

receivables on the existing terms and conditions applicable for dues to the government, by extending loan to the concessionaires and transfer the money to the government. Such payments to be secured by the sovereign guarantee of Government of India (GOI) to provide comfort to the banks. The difference in the applicable interest rate and the interest rate that Banks would be willing to charge GOI against its sovereign guarantee should be treated as guarantee commission payable to GOI. It is important to note that there is no escalation on the risk profile for GOI towards these receivables by providing a sovereign guarantee since in any case the risk of such receipts already lies with the government.

For future receivables, the amount should be advanced to GOI by way of "factoring" such receivables against assignment of the right to receive such ongoing charges to the banks to be adjusted towards principal and interest. For the comfort of the Banks, the sovereign guarantee of GOI should also be provided for such amounts advanced, to cover any shortfall for the bank after recovery of principal and interest (as applicable for loans with sovereign guarantee) over period of concession. Excess recovery to be to the account of GOI.

For further comfort to the banks, the amounts so lent by them against the GOI guarantee should be treated as eligible "investments" for the purpose of SLR (Statutory Liquidity Ratio).

The advantage of the proposed solution to the economy and GOI will be as under :

1. Since the guarantee given by GOI is not treated as part of the borrowing and the amounts received towards the license fee/revenue share from concessions granted are to be accounted on "revenue received basis" for the purpose of Union Budget, the impact on the Union Budget for FY 2022-23 will be as under :
  - (a) Assuming that the current receivables are 5 Lakh Crores, the deficit projected would come down to 6.61 Lakh Crores from 11.61 Lakh Crores bringing down the fiscal deficit of 6.4% of GDP to 4.47% of GDP.
  - (b) Assuming additional 5 Lakh crores as factoring of future receivables as above, the fiscal deficit could further reduce to 6.61 Lakh Crores with a significant reduction in fiscal deficit to only 2.55% of GDP.
2. The market borrowings to be done by the GOI will reduce by 10 Lakh Crores, thereby relieving the pressure on yields on government borrowings and reducing overall interest payment by the government.
3. The excess liquidity in the banking system will be sucked out in an orderly and productive manner without disturbing the risk profile of advances made by the Banks.
4. In case of default by a concessionaire, the bank can invoke GOI guarantee and transfer the debt back to GOI along with concerned securities e.g. winning rights or right over oilfield or spectrum.

It may also be noted that extension of guarantees by GOI to secure debt to third parties has a recent precedence

where the GOI used credit guarantees as a tool in its various schemes to support and enable economic growth during covid. Such schemes include the ECLGS scheme, Credit Guarantees to Micro Finance Institutions, Rs 1.1 lakh crores of loan guarantee scheme for Covid affected sectors including health and tourism etc.

As we all know, these schemes helped in recovery of SME and MSME sectors which had been severely impacted by covid and enabled the banks to freely lend to them in their difficult situation – a step which no bank would have been able to, without such government guarantee. From the report available, the defaults in respect of such advances have been actually lower than the normal NPAs for advances to such sectors.

No doubt that the approach suggested is out of ordinary but then extra ordinary situations do demand and deserve

extra ordinary solutions. I am also conscious that an argument would be raised that this suggestion would only be a 'financial engineering' as subsequent year revenues will be lower. My response to that would be that if one can reduce the current year fiscal deficit by 10 Lakh Crores and increase it by 60 - 70K Crores each year for next 15-16 years (average period of concessions assumed), it would be worth it. With GDP slated to grow at high single digit over next years, the percentage impact will keep getting lower anyway year after year.

The suggestion is being made on the assumption that the current system of Union Budget being on 'receipt basis' will continue for at least the foreseeable future instead of an 'accrual basis' which is the ideal way forward but is unlikely to be adopted any time soon.

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