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Union Budgets 2015 to 2025: Fiscal reforms for long-term impact

February 2025

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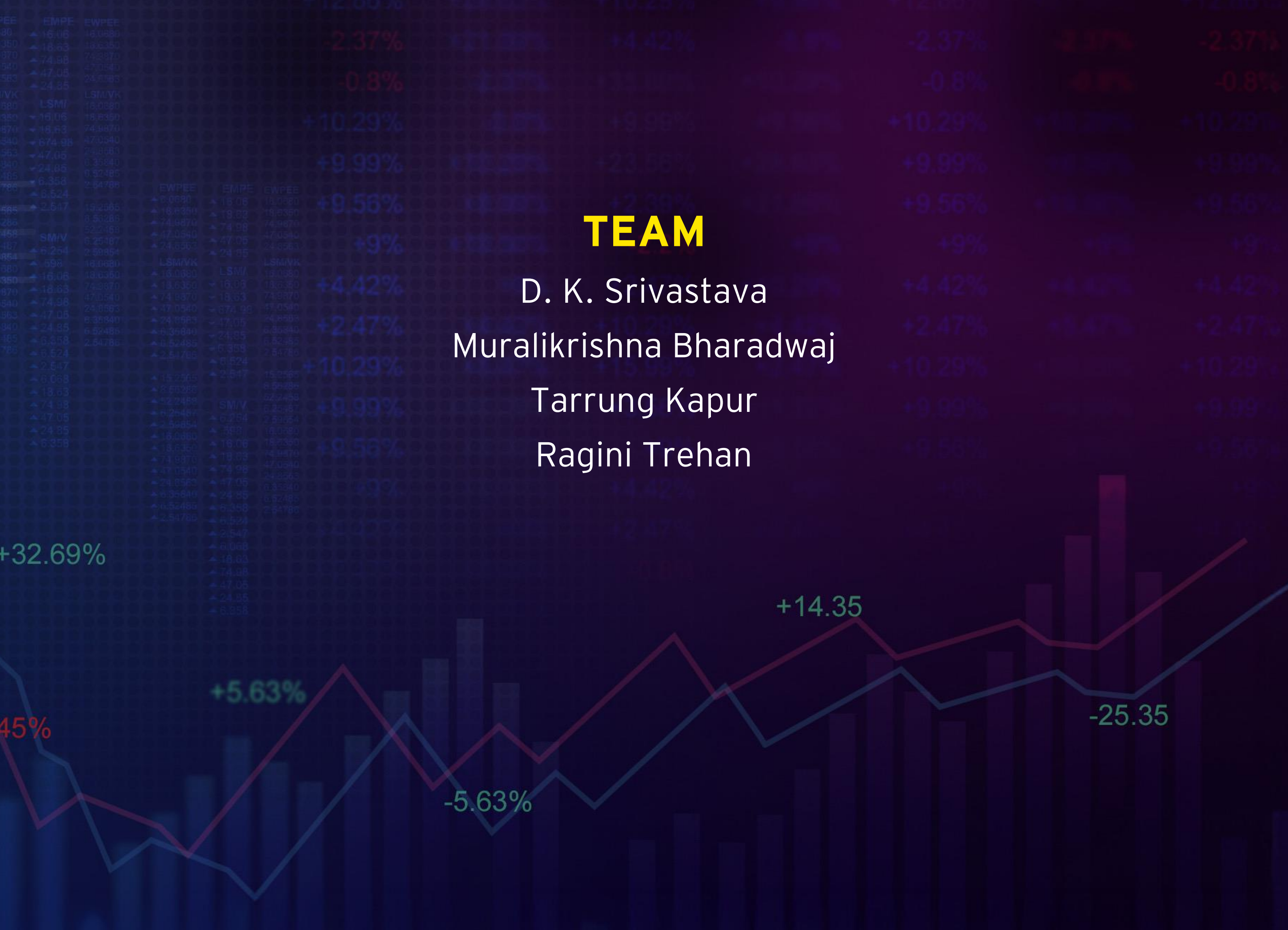
EY Economy Watch

April 2015 to January 2025



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Chapter 1
Overview: Budgets as vehicles of fiscal reforms

Abstract

In this chapter, an overview of GoI's 14 budgets presented between 2015 and 2025, including two interim budgets in 2019 and 2024, is provided. This period was marked by a major economic shock due to COVID affecting FY21. It is remarkable that the GoI progressively created space for capital expenditure expansion by increasing the tax-GDP ratio and by reducing the share of revenue expenditure as a percentage of GDP. The overall increase in capital expenditure relative to GDP of 1.56 percentage points was financed by 0.75% points increase in GoI's revenue receipts, a net increase of capital receipts of 0.1% point and a fall in revenue expenditure of 0.72% points of GDP. Thus, capital expenditure augmentation was financed almost equally by revenue enhancement and expenditure restructuring.

Introduction

The period from 2015 to date was characterized by major upheavals in the global economy, including the occurrence of a totally unanticipated and debilitating onset of COVID-19. Global economic policies moved away from free trade, common markets, and technology sharing to protected and fragmented trade, supply side disruptions and restrictions on sharing the latest technologies and inputs supporting those technologies. In this context, Indian policymakers had to rely relatively more on domestic drivers of growth.

We undertake a review of the way the GoI negotiated its path through economic cycles with domestic and foreign routes. This analysis is prepared by bringing together the 'in-focus' writeups included in the relevant EY Economy Watch editions and selected other in-focus themes that have a bearing on GoI's budgets. The 2015 to 2025 period was characterized by one major economic shock due to the impact of COVID, which primarily affected the fiscal year FY21. Negotiating this particular shock through fiscal and other instruments was the critical test the GoI's budgets of the relevant years addressed. The present analysis also highlights the short and medium-term impacts of the COVID crisis, particularly on fiscal aggregates.

Under the auspices of the NDA in their continuous supervision since FY15, fourteen GoI budgets have been presented, including two interim budgets in 2019 and 2024 (Table 1.1). A series of fiscal reforms were initiated during this period through these annual budgets and outside of these. In this writeup, we take a comprehensive review of the nature of these fiscal reforms and their impact on the economy through these annual budgets. We also suggest next steps and any course correction, if required, for India achieving a Viksit nation status.

Table 1.1: NDA budgets: July 2014 to February 2025

Sl. no	Fiscal year	Date of presentation	Presented by Finance Minister
1.	FY15 Budget	10-Jul-14	Shri Arun Jaitley
2.	FY16 Budget	28-Feb-15	Shri Arun Jaitley
3.	FY17 Budget	29-Feb-16	Shri Arun Jaitley
4.	FY18 Budget	01-Feb-17	Shri Arun Jaitley
5.	FY19 Budget	01-Feb-18	Shri Arun Jaitley
6.	FY20 Interim Budget	01-Feb-19	Shri Piyush Goyal
7.	FY20 Budget	05-Jul-19	Smt. Nirmala Sitaraman
8.	FY21 Budget	01-Feb-20	Smt. Nirmala Sitaraman
9.	FY22 Budget	01-Feb-21	Smt. Nirmala Sitaraman
10.	FY23 Budget	01-Feb-22	Smt. Nirmala Sitaraman
11.	FY24 Budget	01-Feb-23	Smt. Nirmala Sitaraman
12.	FY25 Interim Budget	01-Feb-24	Smt. Nirmala Sitaraman
13.	FY25 Budget	23-Jul-24	Smt. Nirmala Sitaraman
14.	FY26 Budget	01-Feb-25	Smt. Nirmala Sitaraman

Source (basic data): Union Budgets various years

In addition to these budgets related analyses, we have included in this volume some other 'in-focus or related fiscal reform themes' (Table 1.2). In particular, we analyze the potential of non-tax revenues in financing government expenditures. These have remained under exploited over the years. Also, the FY26 budget has shifted to a new approach towards fiscal consolidation. We have

analyzed the underlying logic of Fiscal Responsibility and Budget Management (FRBM) legislations over the years and in this writeup, we examine GoI's new approach and its potential impact on fiscal consolidation.

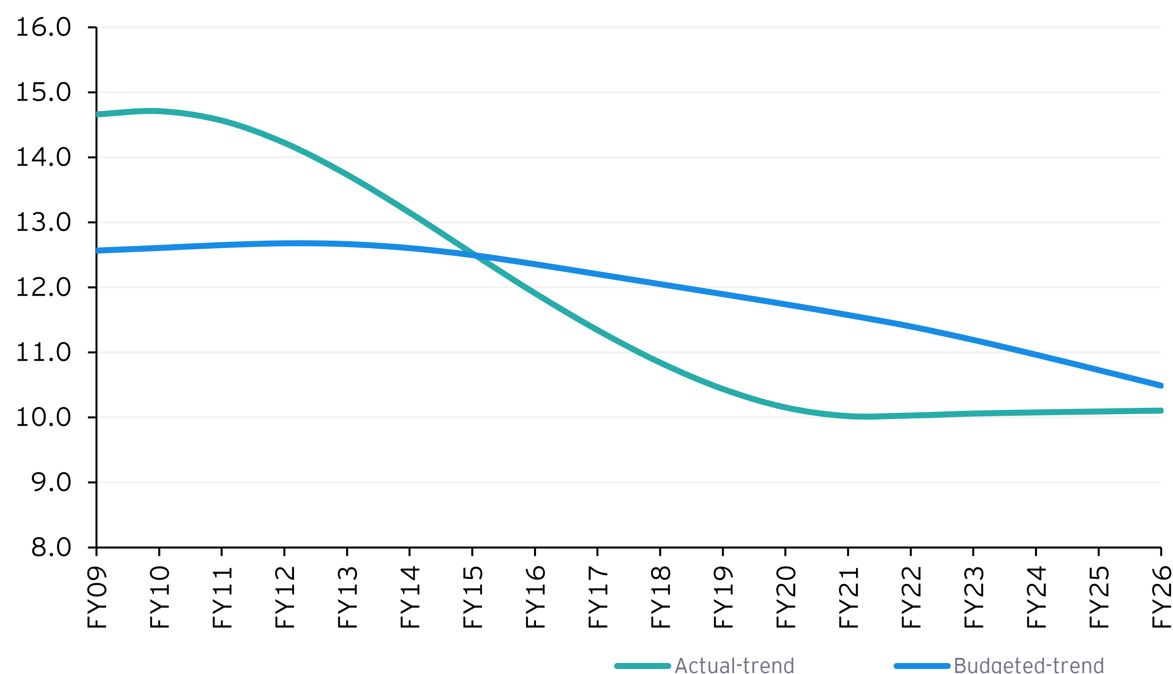
Table 1.2: Selected non-budget related in-focus themes

In-focus title	EY Economy Watch Issue
Has union government's fiscal marksmanship improved over time?	May 2019
India's macro-economy on the eve of the FY19 Budget – Reinvigorating growth	January 2018
Making non-tax revenues count	August 2016
FRBM Review Committee – proposing a new fiscal framework	May 2017

Overestimating nominal GDP growth

In the GoI budgets, an underlying nominal GDP growth assumption is given. The budgets do not contain any analysis of the impact of fiscal variables on real GDP growth. It is notable that in the period prior to FY15, the level of nominal GDP growth was much higher in the range of 12.5% to 15% during FY09 to FY15. This came down sharply and presently the average nominal GDP growth is about 10%. These observations relate to trend values (Chart 1.1) estimated using actual nominal GDP growth data released by the NSO. Looking at the trend values, it is also noticeable that FY15 onwards on a trend basis, the GoI has mostly overestimated the nominal GDP growth.

Chart 1.1: Trend nominal GDP growth: Budgeted and actual (% annual)

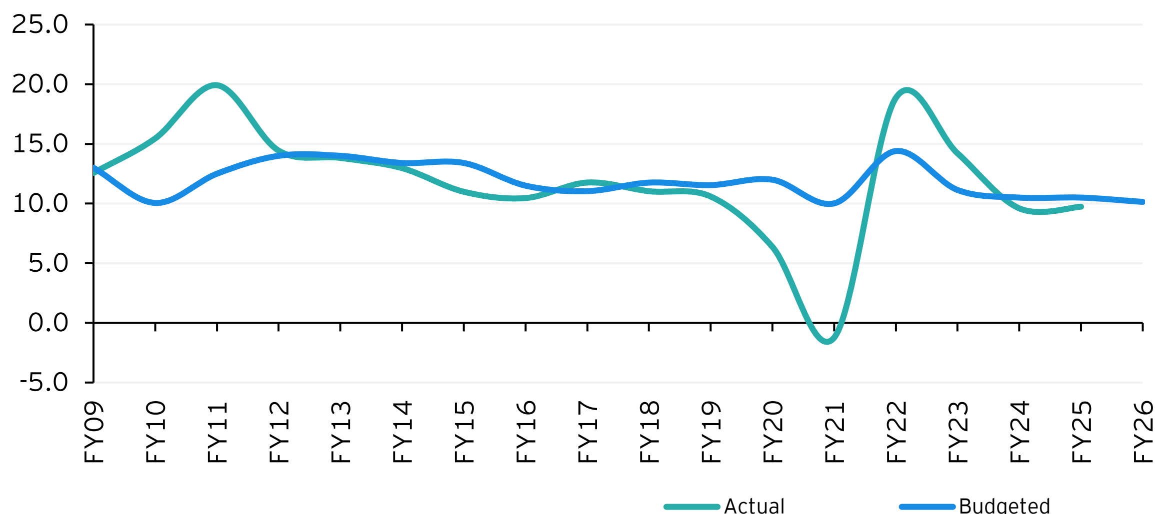


Source (basic data): MoSPI, Union Budget documents

Note: Trend growth has been estimated by using Hodrick Prescott filter

Chart 1.2 gives the corresponding actual nominal GDP growth rates. In the history of nominal GDP growth, a negative growth was encountered for the first time after FY1956 in the COVID year of FY21.

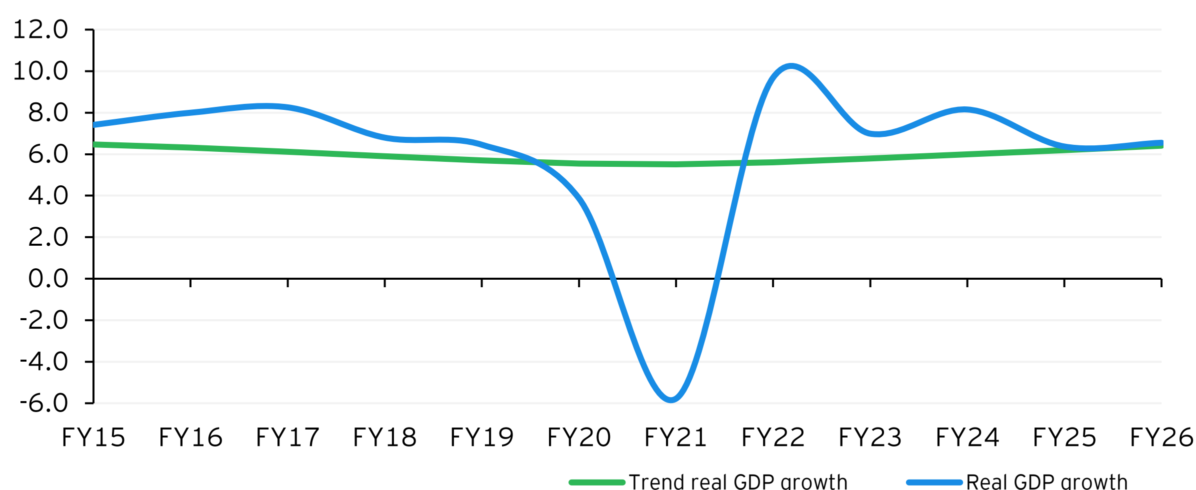
Chart 1.2: Nominal GDP growth: Budgeted and actual (% annual)



Source (basic data): MoSPI, Union Budget documents

Although the budget itself does not give the real GDP growth estimates, the fiscal aggregates impact real GDP growth in a significant way. Chart 1.3 gives the path of trend and actual real GDP growth rates over the period FY15 to FY25. In the history of real GDP growth, although cyclical fluctuations did occur periodically, and growth rates dipped from time to time, these remained positive. After FY1980 a negative real GDP growth was encountered for the first time in FY21, when real GDP saw a sharp contraction of (-)5.8%. The GoI relied heavily on countercyclical fiscal policy to cope with such a shock. It seems that after the formulation of the Monetary Policy Framework, the countercyclical role of monetary policy was subdued even in the presence of such a major economic shock. In contrast, there was a much greater reliance on the countercyclical role of fiscal stimulus. The combined fiscal deficit had increased to 12.5% of GDP, of which GoI's fiscal deficit was 9.2%[1]. As a result, the combined debt-GDP ratio increased close to 90%[2] in FY21 and GoI's debt-to-GDP ratio increased to nearly 61%.

Chart 1.3: Trend and actual real GDP growth (% annual)

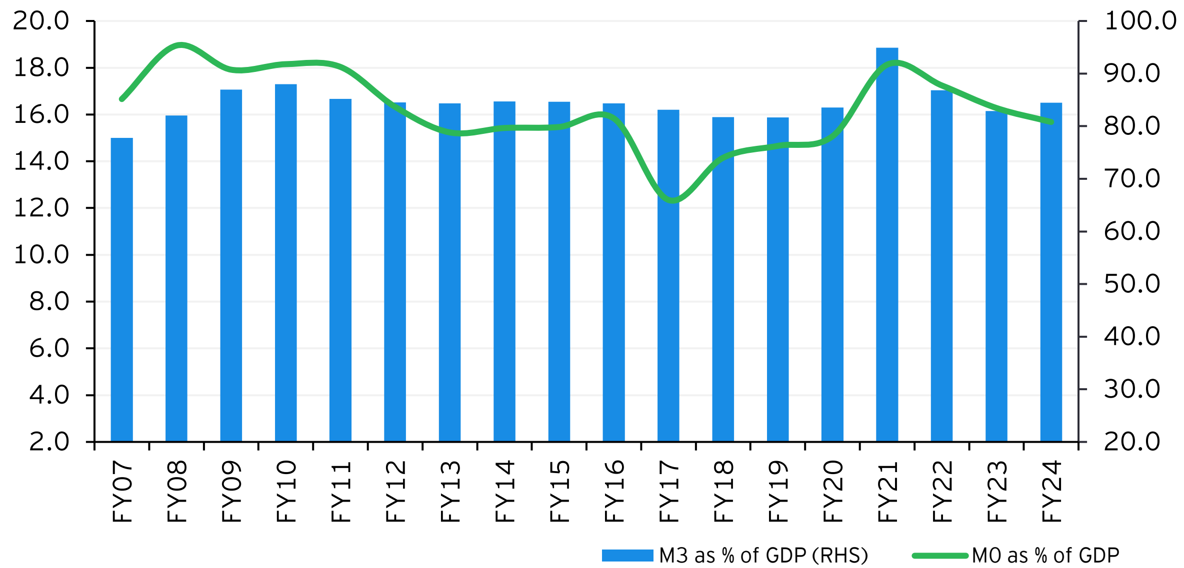


[1] Includes on-lending from GoI to states
[2] Debt measured at market exchange rates

Source (basic data): MoSPI, Union Budget documents
Note: Trend growth has been estimated by using Hodrick Prescott filter

In contrast, the monetary stimulus, when measured as the percentage increase in the ratio of M0 and M3 to nominal GDP respectively, played a subdued role as compared to fiscal stimulus in dealing with the COVID crisis. The 3.0 percentage points increase in M0 relative to GDP, which increased from 15.1% in FY20 to 18.1% in FY21 (Chart 1.4), translates to a growth of 20% in the ratio. The corresponding growth in M3 to GDP ratio was 14%.

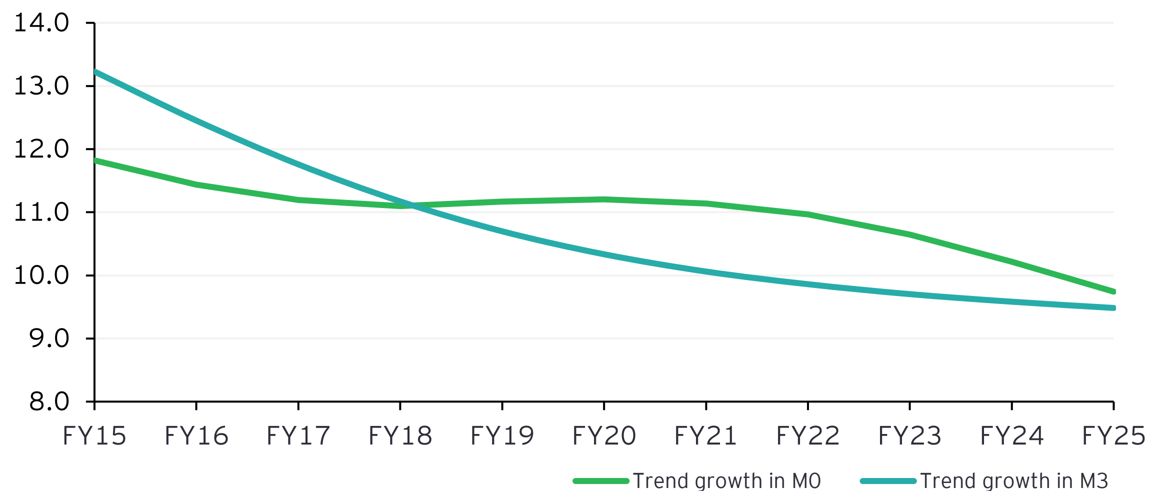
Chart 1.4: M0 and M3 as a % of nominal GDP



Source (basic data): RBI, MoSPI

It is also seen that, on a trend basis, M3 growth has been steadily falling. It has fallen below 10% in recent years (Chart 1.5). It would appear that nominal GDP growth path is closely following M3 growth path reminding us of the well-known Friedman's Quantity Theory of money[3].

Chart 1.5: Trend growth in M0 and M3 (% annual)



Source (basic data): RBI

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[3] Quantity Theory of Money - an overview | ScienceDirect Topics

Note: Trend growth has been estimated by using Hodrick Prescott filter

Coping with COVID shock

The period from FY15 to FY26 (BE) was characterized by the major unprecedented economic shock of the COVID crisis. It induced a response in terms of a major fiscal stimulus, which becomes clear by focusing on the fiscal aggregates in FY20 vis-à-vis FY21. The impact of this crisis on GoI's revenue receipts was marginally positive when we consider FY21 revenue receipts over those of FY20 relative to GDP. However, it was through a sharp increase in the fiscal deficit to GDP ratio that a significant increase in total expenditure to GDP ratio was financed. In fact, GoI's total expenditure increased by 4.32 percentage points of GDP (Table 1.3) in FY21 which amounts to 32.3% of previous year's total expenditure of the GoI relative to GDP. This is much higher than the extent of monetary stimulus.

Table 1.3: Key fiscal aggregates of the GoI as a % of GDP

	RR	NetTR	NTR	NDCR	FD	TE	RE *of which*	SS	CE
FY15	8.83	7.25	1.59	0.41	4.10	13.34	11.77	2.07	1.58
FY16	8.68	6.85	1.82	0.46	3.87	13.00	11.17	1.92	1.84
FY17	8.93	7.16	1.77	0.42	3.48	12.83	10.98	1.53	1.85
FY18	8.40	7.27	1.13	0.68	3.46	12.53	10.99	1.31	1.54
FY19	8.22	6.97	1.25	0.60	3.44	12.25	10.62	1.18	1.63
FY20	8.38	6.75	1.63	0.34	4.64	13.36	11.69	1.30	1.67
FY21	8.23	7.18	1.05	0.29	9.16	17.68	15.53	3.82	2.15
FY22	9.20	7.65	1.55	0.17	6.71	16.08	13.56	2.14	2.51
FY23	8.84	7.78	1.06	0.27	6.45	15.56	12.81	2.14	2.75
FY24	9.24	7.88	1.36	0.20	5.60	15.04	11.83	1.47	3.21
FY25	9.53	7.89	1.64	0.18	4.84	14.55	11.41	1.32	3.14
FY26	9.58	7.95	1.63	0.21	4.40	14.19	11.05	1.19	3.14
percentage points									
FY21 minus FY20	*-0.15*	*0.43*	*-0.58*	*-0.05*	*4.51*	*4.32*	*3.84*	*2.51*	*0.48*
FY26 minus FY15	*0.75*	*0.70*	*0.05*	*-0.20*	*0.30*	*0.85*	*-0.72*	*-0.88*	*1.56*

Source (basic data): Union Budgets various years and MoSPI.
Note: Data for FY25 pertains to revised estimates and that for FY26 pertains to budget estimates; Abbreviations used are as follows: RR-Revenue receipts, NetTR-Net tax revenue, NTR-Non-tax revenue, Non-debt capital receipts-NDCR, FD-Fiscal deficit, TE-Total expenditure, RE-Revenue expenditure, SS-Subsidies, CE-Capital expenditure

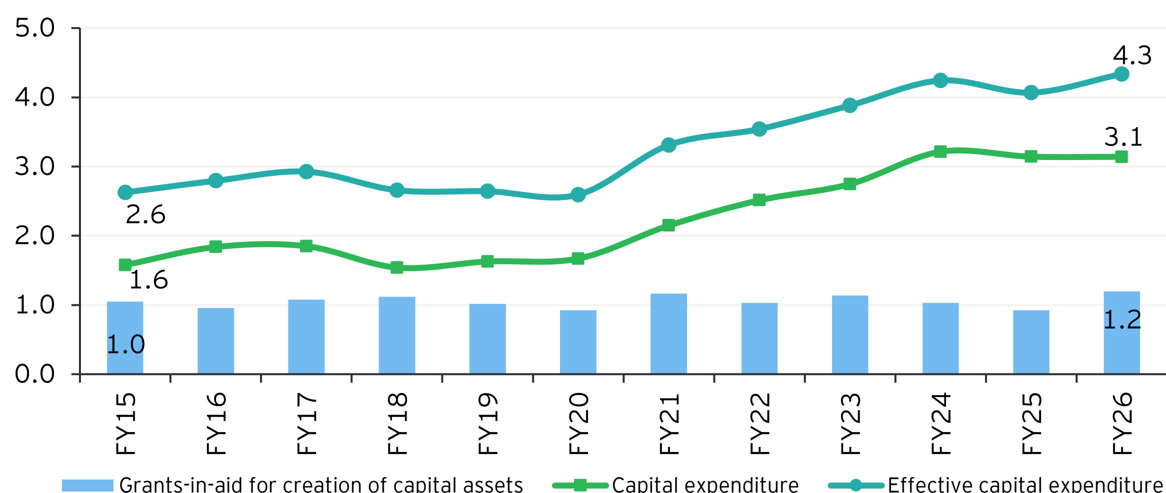
Creating budgetary space for infrastructure expansion

The longer-term story, however, of the period from FY15 to FY26 (BE) is GoI's effort to create fiscal space for augmenting capital expenditure. As a percentage of GDP, GoI's capital expenditure increased from 1.58% in FY15 to 3.14% of GDP in FY26 (BE) (Table 1.3). Measured as a percentage of GoI's total expenditure, capital expenditure increased from 11.8% in FY15 to 22.1% in FY26 (BE) (Annexure 1.1). This increase of more than 10 percentage points in the share of capital expenditure in total expenditure was accompanied by a corresponding decrease in the share of revenue expenditure from 88.2% in FY15 to 77.9% in FY26 (BE). Thus, the overall increase in capital

expenditure relative to GDP of 1.56 percentage points was financed by a 0.75 percentage points increase in GoI's revenue receipts, a net increase of capital receipts of 0.1% point and a fall in revenue expenditure of 0.72 percentage points of GDP. Thus, capital expenditure augmentation was financed almost equally by revenue enhancement and expenditure restructuring.

GoI has been earmarking some portion of its grants to states for building capital assets at the state level. This expenditure is shown as revenue expenditure in the GoI's budget. However, since it is meant for capital asset creation, it is also shown as effective capital expenditure for purposes of assessing GoI's resources being spent on capital formation. This practice is linked to the concept of effective revenue deficit, which is also being reported in the 'Budget at a Glance' statement in the GoI's budget. Chart 1.6 shows that the excess of effective capital expenditure over GoI's capital expenditures has increased in FY26 (BE) to 1.2 percentage points of GDP from 0.9 percentage points of GDP in FY25 (RE). It was at 1.0 percentage point of GDP in FY15.

Chart 1.6: Capital expenditure and effective capital expenditure to GDP ratio



Source (basic data): Union Budgets various years and MoSPI
Note: Data for FY25 pertains to revised estimates and that for FY26 pertains to budget estimates; Grants-in-aid for creation of capital assets is the difference between effective capital expenditure and capital expenditure of the GoI.

There is another route through which the central government is inducing the state governments to undertake capital expenditures. This is done through GoI on-lending interest-free loans to state governments for a period of 50 years, provided they are spent on capital expenditures. This practice was introduced in the COVID year of FY21. Since then, it has been continued although as Table 1.4 shows, state governments have not been able to fully utilize this allocation.

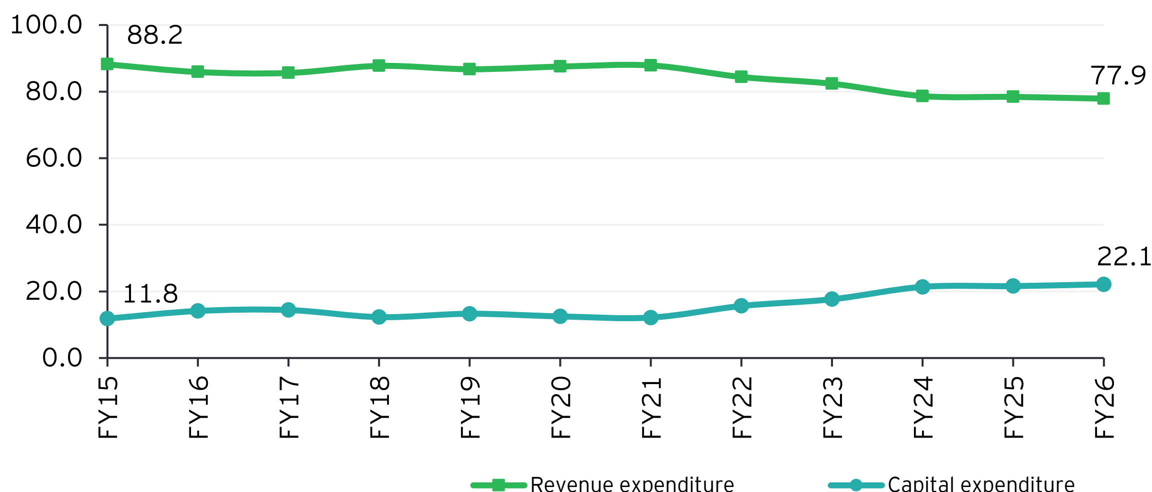
Table 1.4: 50-year interest-free loan to state governments for capital expenditures

Year	Budgetary allocation	Utilization	Ratio of Utilization to Budget allocation
	INR crore		%
FY21		11,830	
FY22	10,000	14,186	141.9
FY23	100,000	81,195	81.2
FY24	130,000	109,554	84.3
FY25	150,000	125,000	83.3
FY26	150,000		

Source: (basic data): Union Budget documents and Response given by the Minister of State, Shri. Pankaj Chaudhary dated 02-Dec-2024 to Lok Sabha on the Unstarred Question[4] No. 1109

Chart 1.7 shows that the share of capital expenditure in total expenditure has nearly doubled from a level of 11.8% in FY15 to 22.1% in FY26 (BE).

Chart 1.7: Share of GoI's revenue and capital expenditure in its total expenditure

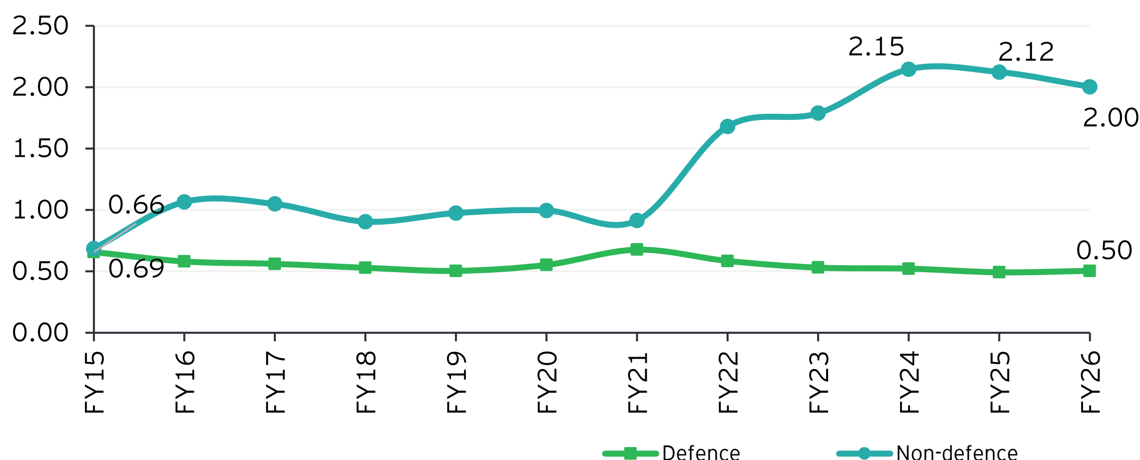


Source (basic data): Union Budgets various years.

Note: Data for FY25 pertains to revised estimates and that for FY26 pertains to budget estimates

Chart 1.8 shows that within capital expenditure, the share of non-defence capital expenditure has been progressively increasing reaching a peak of 2.15% of GDP in FY24. After that it fell marginal to 2% of GDP in FY26 (BE).

Chart 1.8: Non-defence and defence capital expenditure as % of GDP



Source (basic data): Union Budgets various years and MoSPI.
Note: Data for FY25 pertains to revised estimates and that for FY26 pertains to budget estimates

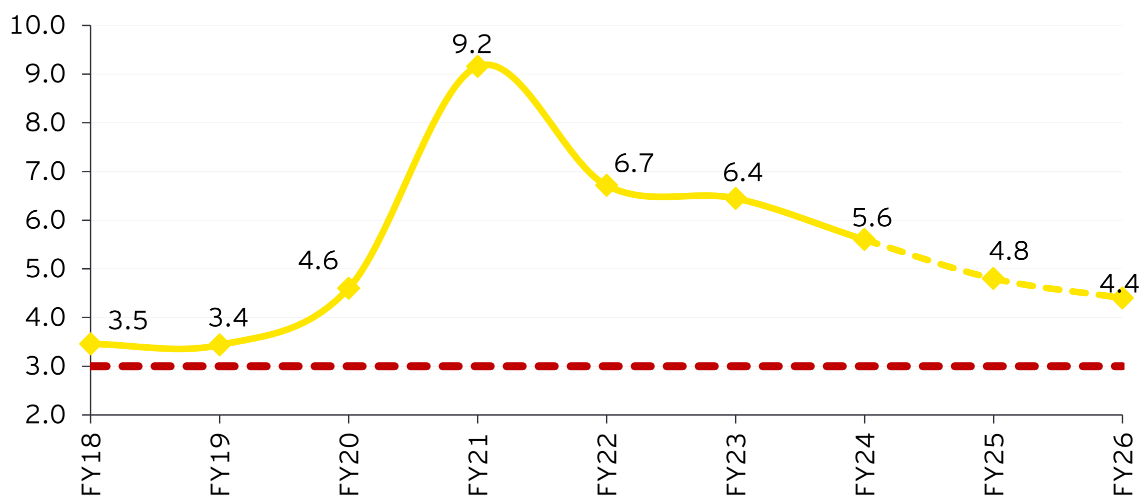
Challenges to fiscal consolidation: From FRBM targets to a new approach

Given the heavy dependance on a fiscal stimulus in order to cope with COVID's contractionary impact, the period FY15 to FY26 (BE) is characterized by a revealing path of GoI's fiscal deficit relative to GDP. It shows that at 3.4% of GDP, the fiscal deficit to GDP ratio came to its closest with

[4] https://sansad.in/getFile/loksabhaquestions/annex/183/AU1109_oPdEyI.pdf?source=pqals

respect to the FRBM target of 3%, in FY19. In FY20, due to the revenue eroding impact of CIT reforms, fiscal deficit had to be increased to 4.6% of GDP. Then the COVID related fiscal stimulus forced GoI's fiscal deficit to rise to 9.2% of GDP (Chart 1.9). The upward path of fiscal deficit took two years to reach this peak. Since then, incrementally, the GoI has been attempting to reduce the fiscal deficit to GDP ratio. However, we are still at a tangible distance from returning to the level of 3.4% or the FRBM target level of 3% of GDP. At this juncture, the GoI has announced a new approach to guiding its fiscal consolidation policy. Instead of a target fiscal deficit relative to GDP, the policy is to be guided by 'an annual reduction in GoI's debt relative to GDP'. This policy has several implications for fiscal consolidation. These are discussed in detail in Srivastava (2024)[5].

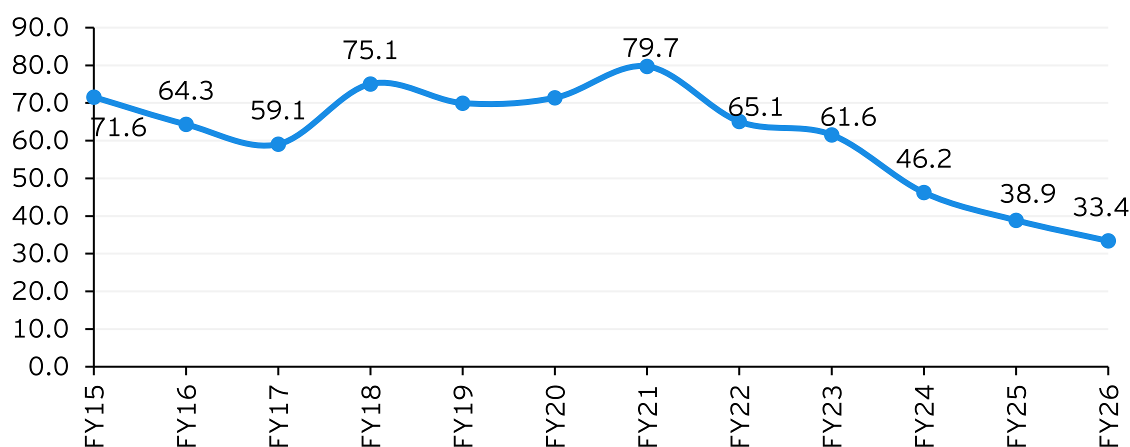
Chart 1.9: GoI's fiscal deficit to GDP ratio



Source (basic data): Union Budgets various years.

One notable feature of the period from FY15 to FY26 (BE) is the consistent improvement in the quality of fiscal deficit as measured by the ratio of revenue deficit to fiscal deficit. This ratio indicates the extent to which borrowing is not used for capital asset formation. Thus, reduction in this ratio indicates improvement in the quality of fiscal deficit. It is also noticeable that this improvement happened largely after FY21, as shown in Chart 1.10.

Chart 1.10: Quality of fiscal deficit (% share of revenue deficit in fiscal deficit)



Source (basic data): Union Budgets various years.

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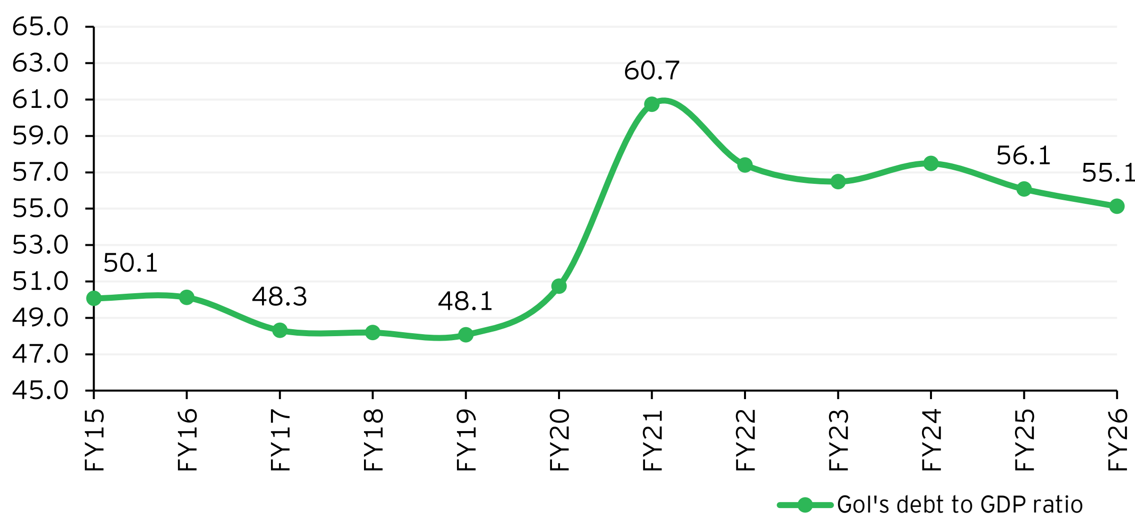
[5] Srivastava, D.K., (2024), Revisiting the Macro Contours of Budget 2024-25, Economic and Political Weekly, Vol 59, Issue No.39 2024 (https://www.epw.in/journal/2024/39/budget-2024-25/revisiting-macro-contours-budget-2024-25.html)

Corresponding to the path of fiscal deficit relative to GDP, the GoI's debt to GDP ratio also peaked at 60.7% in FY21, rising from a trough of 48.1% of GDP in FY19. Chart 1.11 shows that it has taken five years for the GoI's debt-GDP ratio to fall from 60.7% to 55.1% in FY26 (BE), a fall of 5.6 percentage points, that is a fall of nearly 1.1% point per year on average. At this rate, it may take another 15-years to reach the FRBMA-2018 consistent level of 40% of GDP. However, it may also be recognized that within a 15-year period, two Central Pay Commission awards may occur, disturbing the path of fiscal consolidation. The achievement of the FRBM debt target of 40% of GDP might be delayed further.

Chart 1.11: GoI's debt-to-GDP ratio (%)



Source (basic data): Union Budgets various years.

Concluding section

In the GoI budgets, an underlying nominal GDP growth assumption is given. The budgets do not contain any analysis of the impact of fiscal variables on real GDP growth. It is notable that in the period prior to FY15, the level of nominal GDP growth was much higher in the range of 12.5% to 15% during FY09 to FY15. This came down sharply and presently the average nominal GDP growth is about 10%. It is also seen that on trend basis M3 growth has been steadily falling. It has fallen below 10% in recent years. It would appear that nominal GDP growth path is closely following the M3 growth path reminding us of the well-known Friedman's Quantity Theory of Money.

The combined fiscal deficit had increased to 12.5% of GDP, of which GoI's fiscal deficit was 9.2%[6]. As a result, the combined debt-GDP ratio increased close to 90% in FY21, and GoI's debt-to-GDP ratio increased to nearly 61%.

As far as monetary stimulus is concerned, the percentage increase in M0 and M3 relative to GDP, respectively, in FY21 as compared to FY20, were 20% and 14% respectively. Thus, in relative terms, monetary stimulus played a subdued role as compared to fiscal stimulus in dealing with the COVID crisis.

However, it was through a sharp increase in the fiscal deficit to GDP ratio that a significant increase in total expenditure to GDP ratio was financed. In fact, GoI's total expenditure increased by 4.32 percentage points of GDP, which amounts to 32.3% of its previous year's total expenditure relative to GDP. This is much higher than the extent of monetary stimulus.

In FY20, due to the revenue eroding impact of CIT reforms, fiscal deficit had to be increased to 4.6% of GDP. Then the COVID related fiscal stimulus forced GoI's fiscal deficit to rise to 9.2% of GDP. The upward path of fiscal deficit took two years to reach this peak. Since then, incrementally,

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[6] This includes on-lending from GoI to states

the GoI has been attempting to reduce the fiscal deficit to GDP ratio. However, we are still at a tangible distance from returning to the level of 3.4% or the FRBM target level of 3% of GDP.

After peaking at close to 61% of GDP in FY21, it has taken five years for the GoI's debt-GDP ratio to fall to 55.1% in FY26 (BE), a fall of 5.6 percentage points, that is a fall of nearly 1.1 percentage points per year. At this rate, it may take another 15-years to reach the FRBMA-2018 consistent level of 40% of GDP. However, it may also be recognized that within a 15-year period, two Central Pay Commission awards may occur, disturbing the path of fiscal consolidation. The likelihood of achieving the FRBM debt target of 40% of GDP may be delayed further.

Annexure 1.1: Structure of GoI's expenditure: FY15 to FY20 (as a % of total expenditures)

Expenditure heads	FY15	FY16	FY17	FY18	FY19	FY20
Total expenditure	100.0	100.0	100.0	100.0	100.0	100.0
Union government's net tax revenue	54.3	52.7	55.8	58.0	56.9	50.5
Total non-tax revenue	11.9	14.0	13.8	9.0	10.2	12.2
Total non-debt capital receipts	3.1	3.5	3.3	5.4	4.9	2.6
Fiscal deficit	30.7	29.8	27.1	27.6	28.1	34.8
Revenue expenditure of which	88.2	85.9	85.6	87.7	86.7	87.5
Subsidies of which	15.5	14.7	11.9	10.5	9.6	9.8
Other revenue exp	72.7	71.1	73.7	77.2	77.1	77.7
Education	1.8	1.8	1.8	2.1	1.8	1.8
Health	0.6	0.7	0.8	0.9	0.9	1.1
Grants in aid to states	19.7	17.1	14.2	17.4	15.9	18.4
Others	50.5	51.6	56.8	56.9	58.5	56.5
Capital expenditure	11.8	14.1	14.4	12.3	13.3	12.5
Capital outlay	10.1	12.7	12.5	11.4	12.1	11.6
Defence	4.9	4.5	4.4	4.2	4.1	4.1
Non-defence	5.1	8.2	8.2	7.2	8.0	7.5
Loans and advances	1.8	1.5	1.9	0.8	1.2	0.9
Loans to state governments	0.7	0.7	0.9	0.2	0.4	0.2

Source (basic data): Union Budgets various years

Annexure 1.1 (contd): Structure of GoI's expenditure: FY21 to FY26 (BE) (as a % of total expenditures)

Expenditure heads	FY21	FY22	FY23	FY24	FY25	FY26	FY26 minus FY15
Total expenditure	100.0	100.0	100.0	100.0	100.0	100.0	0.0
Union government's net tax revenue	40.6	47.6	50.0	52.4	54.2	56.0	1.7
Total non-tax revenue	5.9	9.6	6.8	9.0	11.3	11.5	-0.4
Total non-debt capital receipts	1.6	1.0	1.7	1.3	1.3	1.5	-1.6
Fiscal deficit	51.8	41.8	41.4	37.2	33.3	31.0	0.3
Revenue expenditure of which	87.9	84.4	82.4	78.6	78.4	77.9	-10.3
Subsidies of which	21.6	13.3	13.8	9.8	9.1	8.4	-7.1
Other revenue exp	66.3	71.1	68.6	68.9	69.3	69.5	-3.2
Education	1.3	1.3	1.4	1.8	1.2	1.2	-0.5
Health	0.9	1.8	0.9	0.9	0.9	0.9	0.3
Grants in aid to states	15.0	14.9	13.8	12.2	11.3	13.0	-6.8
Others	49.0	53.1	52.5	54.0	55.9	54.3	3.8
Capital expenditure	12.1	15.6	17.6	21.4	21.6	22.1	10.3
Capital outlay	9.0	14.1	14.9	17.7	18.0	17.7	7.6
Defence	3.8	3.6	3.4	3.5	3.4	3.6	-1.4
Non-defence	5.2	10.5	11.5	14.3	14.6	14.1	9.0
Loans and advances	3.1	1.5	2.7	3.6	3.6	4.5	2.7
Loans to state governments	0.6	0.6	2.2	2.8	3.0	3.4	2.7

Source (basic data): Union Budgets various years

Chapter 2

Budget 2015-16: Macro implications (April 2015)

Abstract

The GoI's finances were severely squeezed due to a sharp increase of 10 percentage points in the state's share in the divisible pool of central taxes. The economy was still recovering from high levels of fiscal deficit relative to GDP in the period following the 2008-09 crisis. GoI's fiscal deficit had reached a level of 6.6% in 2009-10 and 5.9% in 2011-12. The NDA government inherited a fiscal deficit level of 4.5% of GDP in 2013-14, which needed to be reduced to the sustainable level of 3% as per the FRBM norm. To achieve this, the GoI started adjusting the fiscal deficit downward by reducing the capital expenditure-to-GDP ratio on one hand and increasing the service tax rate on the other. The FY16 budget targeted a fiscal deficit-to-GDP ratio of 4.1%, based on a nominal GDP growth projection of 11.5% and a real GDP growth target of over 8%.

Introduction

Availability of provisional data for FY15 provides the basis for an assessment of the actual deviations in FY15 and recalibration of the magnitudes given in the budget for FY16. In this section, we look at the main features of the central budget for FY16 in the light of the provisional actual figures for FY15 as released by the CGA.

Highlights

- The budget has targeted a growth rate in the range of 8 to 8.5%. Comparing the mid-point of this range with the 7.3% growth of 2014-15, an increase of one percentage point is being targeted.
- Government maintains the fiscal deficit target of 4.1% of GDP for FY15 but plans for a fiscal deficit to GDP ratio of 3.9% for FY16 against the previous target of 3.6%, asking for one more year to reach the FRBMA target of 3% by FY 18.
- The key underlying feature affecting all budgetary dimensions is sluggish tax revenue growth. Against a budgeted target of 17.7% growth in FY 15, according to revised estimates, the government is likely to achieve less than 10% growth.
- As per the recommendations of the 14th Finance Commission, 42% of the central taxes will be transferred to the states. This, supplemented by other grants recommended by the Finance Commission, has marginally reduced the fiscal space for the central government but increased the autonomy of the states.
- Retaining the fiscal deficit target at 4.1% of GDP implies that adjustment comes from the expenditure side, resulting in an overall contractionary stance.
- The larger burden of adjustment has been on capital expenditure.

Revenues

The Union government's gross tax revenue is budgeted to grow by 16.4% in FY16 as compared with the provisional actuals (PR) for FY15 (Table 2.1). While the estimated revenue growth from corporate tax and customs are estimated to be around 9.7% and 10.8% respectively in FY16, revenue growth from excise duties (21.5%), service tax (24.9%) and income tax (26.7%) are budgeted to grow at significantly higher rates.

Table 2.1: Major heads of central government revenue (INR crores)

Revenue heads	2014-15 (PR)	2015-16 (BE)	% Change in FY16 BE over FY15 PR
Gross revenue receipts	14,41,996	16,71,223	15.9
Tax revenue (incl. States share)	12,45,037	14,49,490	16.4
Corporation tax	4,28,925	4,70,628	9.7
Taxes on Income	2,58,386	3,27,367	26.7
Customs	1,88,013	2,08,336	10.8
Union excise duties	1,89,070	2,29,808	21.5
Service tax	1,67,990	2,09,774	24.9
Non-tax revenue	1,96,959	2,21,733	12.6

Source (basic data): Union Budget 2015-16, Controller General of Accounts

A. Expenditures

The Union government's overall expenditure is expected to grow by 8.1% in FY16. The overall non-plan expenditure growth is budgeted at 10.2% for FY16 relative to the provisional actuals for FY15 while the plan expenditure is expected to grow only by 2.6% in FY16 (Table 2.2). By major type of expenditure, the growth in revenue expenditure is projected at 5.4% while the growth in capital expenditure is set at a very high pace of 29.1% in FY16 relative to FY15 provisional actuals.

Table 2.2: Major heads of central government expenditure (INR crores)

Expenditure Heads	FY15 (PR)	FY16 (BE)	% Change in FY16 BE over FY15 PR
Total expenditure	16,44,761	17,77,477	8.1
Non-plan	11,91,140	13,12,200	10.2
Plan	4,53,621	4,65,277	2.6
Revenue	14,57,748	15,36,046	5.4
Capital	1,87,013	2,41,431	29.1

Source (basic data) : Union Budget

The subsidy burden of central government has been projected to reduce from 2.0% of GDP in FY15 (BE) to 1.6% in FY16 (BE) (Table 2.3). This is largely on account of a reduction in the petroleum subsidies in FY16. With the deregulation of diesel prices and rationalization of LPF subsidy on the back of easing of global crude prices, the government has got much needed opportunity to push for reforms in fuel prices and reduce its financial burden.

However, food subsidy burden is set to remain as the major contributor to overall subsidies even in FY16. In the event of a below average monsoon during FY16 and the possibility of lower agricultural output in FY15, the food subsidy burden may end up being even higher during FY16.

Table 2.3: Major subsidies (INR crores)

	FY15 (BE)	FY16 (BE)	% of GDP FY15 BE	% of GDP FY16 BE
Major subsidies *of which*	251397.25	2,27,388	2.0	1.6
Fertilizer	72970.30	72,969	0.6	0.5
Food	115000.00	1,24,419	0.9	0.9
Petroleum	63426.95	30,000	0.5	0.2

Source (basic data): Union Budget 2015-16

B. Prospects

The total central government expenditure budgeted at 12.6% of GDP for FY16 is at a historical low because of the resource crunch. With the union government's fiscal space being limited, the initiative for increasing investment will have to come from state governments, public and departmental enterprises, and the private sector, both domestic and external. With inflation in general and petroleum product prices in particular keeping low, household demand would eventually pick up as their real disposable incomes increase and cost of products fall. The public sector may also be persuaded to activate their expansion plans aggressively. At the same time, the central government should more aggressively cut subsidies and take measures to improve government expenditure efficiency by eliminating the plan non-plan distinction.

The main constraints to growth should also be recognized. First, the service tax hike will dampen growth in the one sector that has been performing relatively better; second, a tilt to manufacturing at the cost of services requires a higher capital-output ratio, which is not called for when the saving and investment rate are well below desirable and previously achieved peak levels; and third, announcing a graduated reduction in corporate tax rate without actually taking any first step may induce potential investors to postpone investment decisions to future.

Chapter 3

Budget 2016-17: A macro-fiscal perspective (March 2016)

Abstract

The FY17 budget had called for reviewing the Union government's FRBM Act. GoI was looking for a countercyclical dimension to the FRBM Act of 2003. The budget also looked for structural fiscal reforms so that additional fiscal space could be created to increase capital expenditure growth. Such reforms were initiated by focusing on direct transfers to beneficiaries and reducing subsidy levels relative to GDP, accompanied by better targeting. The underlying nominal GDP growth assumption was 11%. This was also the year when the recommendations of Seventh Central Pay Commission were implemented, affecting GoI's revenue expenditures through hikes in pensions and salaries of government employees. As a result, GoI's revenue expenditure grew by 9.9% in FY17 as compared to 4.8% in FY16, an increase of 5.1% points.

Introduction

In formulating the Central Budget for FY17, the policymakers had to take into account the adverse global economic headwinds. With China and other major emerging market economies (EMEs) slowing down, India's exports have been falling since October 2014. Domestically, growth in private corporate investment has been sluggish. Fiscal expansion can provide stimulus to overcome this demand deficiency coming from both external and domestic sectors. But in India's case, the scope of this expansion is limited by the limit imposed by the Fiscal Responsibility Legislation. The central government had, in its FY16 Budget, provided a fiscal consolidation roadmap targeting a fiscal deficit of 3.9% for FY16 and 3.5% for FY17. The FY17 Budget has reaffirmed government's commitment to these targets.

Fiscal consolidation and growth

Given the limits on fiscal deficit, the Central government expenditure could be expanded by increasing tax and non-tax revenues relative to GDP, and non-debt capital receipts. As Table 3.1 shows, in spite of somewhat higher revenue receipts relative to GDP in FY17 as compared to RE of FY16, total expenditure relative to GDP actually falls marginally from 13.16 to 13.13. The larger fall is in the budgeted capital expenditure. In fact, government expenditure as a percentage of GDP, has steadily fallen from 13.32% in FY15 to 13.16% in FY16 (RE) and 13.13% FY17 (BE). In FY16, it was the revenue expenditure which fell by a much larger margin. Clearly, adherence to the fiscal deficit target and limited increase in tax revenues has effectively constrained the increase in government expenditure relative to GDP.

Table 3.1: Adjustments that enabled reduction in fiscal deficit

Item	2014-15 Actuals	2015-16 RE	2016-17 BE	2015-16 RE minus 2014-15 Actual	2016-17 BE minus 2015-16 RE
	(% to GDP)			(% points of GDP)	
Revenue receipts	8.82	8.89	9.14	0.070	0.251
Tax revenue (net to GoI)	7.24	6.98	7.00	-0.252	0.013
Non-tax revenue	1.58	1.91	2.14	0.322	0.238
Capital receipts excluding fiscal deficit	0.41	0.33	0.45	-0.086	0.120
Fiscal deficit	**4.09**	**3.94**	**3.54**	**-0.146**	**-0.400**
Total expenditure	13.32	13.16	13.13	-0.162	-0.029
Revenue expenditure	11.75	11.41	11.49	-0.340	0.083
Capital expenditure	1.57	1.75	1.64	0.177	-0.112
Additional revenue				0.070	0.251
Additional non-debt capital receipts				-0.086	0.120
Expenditure reduction				-0.162	-0.029
Change in fiscal deficit*				***-0.146***	***-0.400***

Source: Union Budget, 2016-17
Note: * Equal to expenditure reduction minus additional revenue minus additional non-debt capital receipts

However, the government appears to be relying on off-budget borrowings through specialized funds. Estimates suggest that these could amount to 0.9% of GDP. It also anticipates that the RBI might reduce the policy rate to provide the stimulus through the monetary side.

Credibility of the fiscal deficit numbers

Doubts are currently being raised concerning the credibility of the budgeted deficit at 3.5% of the GDP for FY17. First, it is argued that the assumed nominal GDP growth for FY17 at 11% is an overestimate, given that the WPI inflation has been negative in recent quarters. The assumption of an 11.5% nominal GDP growth for FY16 was belied by a margin of nearly three percentage points. Second, there is clearly an under-provision of expenditures, particularly those related to subsidies, pay and allowances and pensions, in the light of the recommendations of the 7th Central Pay Commission (Table 3.3). We estimate that these under provisions could amount to as much as 1.45% of GDP. Third, the revenue optimism concerning the non-tax revenues and non-debt capital receipts is being questioned. In the case of non-tax revenues, the budgeted growth for FY17 is 25% and in the case of non-debt capital receipts, it is budgeted at 52%. Fourth, even in the case of tax revenues, while the overall buoyancy appears to be reasonable, there would be major challenges with respect to Union Excise Duties as the crude prices are not likely to continue to fall depriving the Central government of the kind of bounty that it reaped in FY16 (Table 3.2).

Table 3.2: Tax receipts

Receipts	2014-15 Actual	2015-16 RE	2016-17 BE	% Change in FY16 RE over FY15 Actual	% Change in FY17 BE over FY16 RE
Total gross tax revenue	**12,44,885**	**14,59,611**	**16,30,888**	**17.2**	**11.7**
Corporation tax	4,28,925	4,52,970	4,93,923	5.6	9
Taxes on Income	2,65,733	2,99,051	3,53,174	12.5	18.1
Direct taxes	**6,95,744**	**7,52,021**	**8,47,097**	**8.1**	**12.6**
Customs	1,88,016	2,09,500	2,30,000	11.4	9.8
Union excise	1,89,952	2,84,142	3,18,670	49.6	12.2
Service tax	1,67,969	2,10,000	2,31,000	25	10
Indirect taxes	**5,45,937**	**7,03,642**	**7,79,670**	**28.9**	**10.8**

Source: Receipt Budget, Union Budget, 2016-17

Table 3.3: Amount unpaid/ un-provided for in the Union Budget 2016-17

Items	Under provision* (in INR crore)
Fertilizer subsidy	53500
Food subsidy	39526
LPG and kerosene subsidy	11491
Total subsidies	104517
Pay and allowances (P&A)	83917
Pensions incl. OROP	8359
Grand total	196793
Nominal GDP	13567192
Under provision as a % of GDP	1.45

Notes to Table 3.3:

1. Shortfall in P&A has been derived by taking the difference between the 7th CPC estimate for P&A and Total P&A as taken from the Union Budget 2016-17.
2. Pay and allowances are the sum of three components, namely P&A (civil), P&A (defense) and P&A (railways).
3. Shortfall in pensions is mainly due to OROP.
4. Total pensions is the sum of four components namely pensions (civil), pensions (defense), pensions (railways) and pensions (Dept. of Posts)
5. Pensions (railways) are taken from the Railway Budget, 2016-17.
6. Pensions (dept. of posts) are taken from Demand no. 13 (Department of Posts), Expenditure Budget, Volume II, 2016-17.

Source: Fertilizer Association of India (FAI), Food Corporation of India (FCI), Petroleum Planning and Analysis Cell (PPAC), Report of the 7th CPC (November 2015), Press Information Bureau, GOI, Union Budget 2016-17, Railway Budget 2016-17
Notes: * incl. carry forward of previous years

Growth stimulus based on structural reforms

Pursuing structural reforms might have provided a more sustainable route to supporting growth. First, subsidies could have been substantially reduced by limiting these to say 1% of GDP with better targeting and delivery while weeding out unwarranted middle to high income beneficiaries. In reforming subsidies, the government has been proceeding somewhat slowly. Second, the central ministries and departments, particularly those dealing with state subjects, should have been scaled down in view of the recommendations of the 14th Finance Commission. Third, a clearer path to GST implementation should have been prepared. This would require elimination of cesses rather than adding on to them. While on the one hand, the Budget did announce the elimination of a large number of small cesses being administered by Central Departments other than the Department of Finance, in revenue terms, the share of cesses has been increased. The share of cesses and surcharges in FY15 was only 8.4% of union government's gross taxes, excluding Union Territory taxes. As per the FY17 Budget, this share has been increased to 11.7%. This effectively reduces the divisible pool and takes the states away from the autonomy stipulated by the Finance Commission. Fourth, a concerted effort to raise India's tax-GDP ratio from the range of 16-17% to 21-22%, considering Central and state taxes together, should have been made as the Economic Survey points out. There is hardly any increase in the ratio of union government's gross tax revenue relative to GDP between RE of FY16 and BE of FY17, which are 10.76% and 10.83%, respectively. The union government's gross tax revenue-GDP ratio should be increased by extensive base broadening and substantially weeding out exemptions. The efforts in this direction are negligibly incremental. Without an increase in the tax-GDP ratio in the medium term, the prospects of exploiting our demographic dividend by substantial increases in health and education expenditures would remain dim.

The Budget has called for reviewing the union government's FRBM Act. This is a positive initiative. The FRBM can be provided a countercyclical dimension and a framework in which there is flexibility between the central and state fiscal deficits as long as the consolidated fiscal deficit is kept under an overall limit. If the state governments borrow less than their overall limit, the Central government can borrow more than its own limit and vice versa. The matter is being referred to a committee. A suitable revision would open up fiscal space for enhancing public investment in conditions when the actual growth is less than potential growth.

Chapter 4
Making non-tax revenues count (August 2016)

Abstract

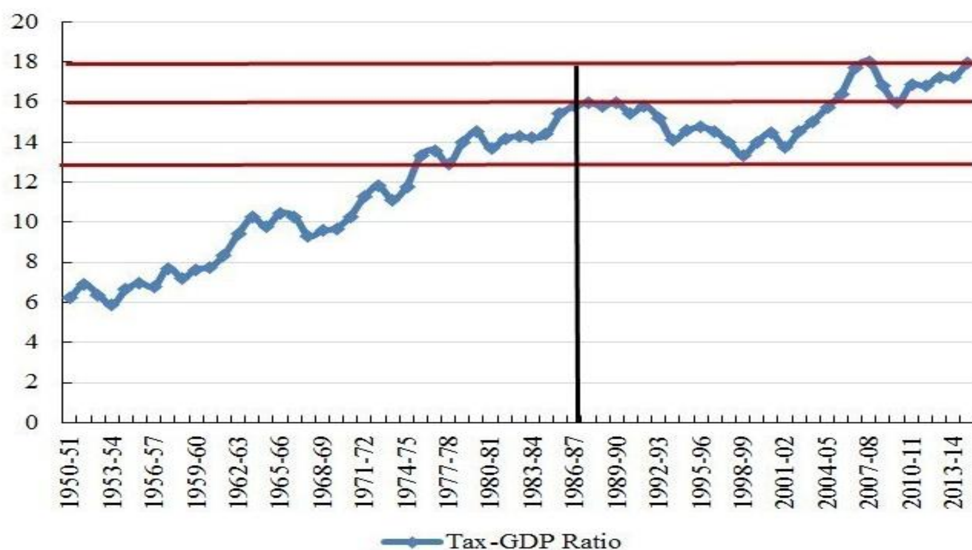
Between FY17 and FY18 budgets, the ‘in-focus’ section of EY Economy Watch in August 2016 took up the subject of non-tax revenues, which has remained under-analyzed over the years. The non-tax revenues relative to GDP have languished in the range of 2 to 3% over a long period. Non-tax revenues arise from government’s ownership of financial and physical assets as well as services provided by the government. Physical assets include minerals, land, forests, water, buildings, and space. Financial assets relate to equities owned and loans given by the government. Both central and state governments also provide a number of services that are subject to fees or user charges. Many of these services are private in nature, where principles of cost recovery can be applied. Revenues earned from these sources are much less than their potential. We highlighted the importance of improving the recovery rates of publicly provided private and merit services and the need for a plan to better realize the value of government-owned assets including land.

Introduction

In financing government expenditure, taxes are often discussed, but much attention is not paid to the role of non-tax revenues. While the tax-GDP ratio is close to a level of 18% now (Chart 4.1), the non-tax revenues relative to GDP have languished in the range of 2 to 3% over a long period (Chart 4.2).

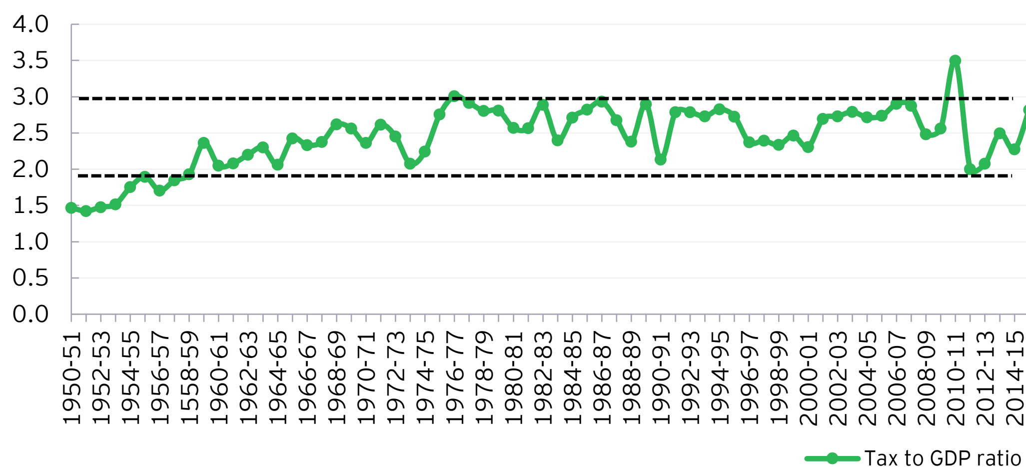
Non-tax revenues arise from government's ownership of financial and physical assets as well as services provided by the government. Physical assets include minerals, land, forests, water, buildings, and space. Financial assets relate to equities owned and loans given by the government. Both central and state governments also provide a number of services that are subject to fees or user charges. Many of these services are private in nature where principles of cost recovery can be applied. Revenues earned from these sources are much less than their potential. Only lately, price discoveries are being made through auctions of minerals and spectrum. In the case of publicly provided goods and services, under-recoveries of costs have implied large unwarranted implicit subsidies.

Chart 4.1: Tax revenues as % of nominal GDP- Combined



Source: Indian Public Finance statistics, Ministry of Finance

Chart 4.2: Non-tax revenues as % of nominal GDP - Combined



Source: Indian Public Finance statistics, Ministry of Finance

In comparison to a selected set of countries (Table 4.1), India's non-tax revenues contribute the lowest relative to GDP. Countries that are rich in minerals particularly oil, show a relatively high level of non-tax revenues relative to GDP.

Table 4.1: Non-tax revenues as a % of GDP: Selected countries

Country	2008	2009	2010	2011	2012	2013	2014
Russia	17.1	13.2	12.4	15.1	13.7	13.2	12.6
Canada	8.1	7.6	7.7	7.6	7.1	7.2	7.0
South Africa	6.3	6.5	6.6	7.3	6.3	6.9	7.7
Brazil	5.3	4.6	5.3	5.3	6.3	5.9	4.8
United States	4.5	4.9	5.1	5.0	4.9	5.5	5.0
Germany	4.3	4.7	4.7	5.0	4.9	4.9	5.0
United Kingdom	3.7	3.8	3.5	3.3	3.3	4.4	3.8
China	4.5	5.0	4.5	3.7	3.9	4.1	---
Japan	5.7	4.8	4.0	3.6	3.1	3.4	3.8
India*	2.8	2.4	2.5	3.4	2.0	2.1	2.5

Source: IMF Government Finance Statistics and Ministry of Finance, Government of India
* Data pertains to fiscal year

Ownership of resources

Government owns resources on, below and above land as well as in the territorial waters (12 nautical miles or 22.2 km from the base line). However, an authentic enumeration or valuation of these resources is not readily available. The Ministry of Defence has recently estimated that the land owned by it amounts to 17.57 lakh hectares. In a recent write-up, Debroy[7], a member of the Niti Ayog, indicates that the railways own 4.40 lakh hectares (43,000 hectares identified as land not required for operational purposes), port trusts have 6,300 hectares (some uncertainty about this data), the Airports Authority of India has 20,400 hectares, India Post has at least 1,900 vacant plots of prime real estate and central PSUs possess 95 lakh hectares of surplus land. Similarly, there would be large land ownerships with the state and local governments, although no centralized data are available.

Ownership of minerals and water are equally valuable. Recent coal auctions have led to significant revenues for the state governments. Similarly, the central government has had some windfall gains through spectrum auctions. A recent study (CBGA, 2014) has estimated that the value of hydrocarbon and other mineral resources available in the country is at least INR 5011.6 lakh crore[8]. This amounts to almost 37 times India's GDP at current prices in 2015-16. In order to exploit the revenue potential of these resources, new initiatives are needed. First, an exhaustive survey, enumeration and compilation of ownership records of these resources are needed. Second, a modern office to serve the role of an estate manager is called for. Third, a suitable policy is required to ensure inter-generational equity in the exploitation of this ownership of the government, for not only the present generation but for all future generations.

In the case of equity and loans, studies have quantified the implicit subsidies which arise since the returns are much less than the annual interest cost of borrowing of funds. To the extent that these subsidies are unjustified, corrective action is needed including disinvestment to liquidate these assets. The low returns on public sector investments reveal the presence of inefficiencies in the

[7] Indian Express, published November 13, 2015; http://indianexpress.com/article/opinion/columns/all-the-sarkars-land/
[8] Kundu, S.,"A Note on the Estimated Value of Government-Owned Natural Resources in India", Centre for Budget and Governance Accountability (2014).

public sector. In many of these cases, disinvestment is the only viable option. In June 2016, the Niti Aayog identified 32 such loss-making companies for strategic disinvestment.

Cost recovery in publicly provided services

Quite a number of studies[9] have highlighted the low-cost recoveries in the public provision of private goods. Even after excluding some services with positive externalities such as health and education, where a degree of subsidization may be justifiable, better cost recoveries would add tangibly to government's non-tax revenues. The extent of under-recovery of costs keeps increasing because the concerned prices are usually administered and these are infrequently revised upwards, even though costs are continuously increasing. We need to determine a desired degree of subsidization for each of the goods/service provided and then provide for a built-in mechanism which enables a periodic and automatic upward revision of prices linked to the costs.

Current structure of non-tax revenues

Table 4.2: Share of selected components in total non-tax revenues: Union government and combined

	1995-00	2001-05	2006-10	2010-11	2011-12	2012-13	2013-14 (RE)	2014-15 (BE)
Combined								
Contribution of public undertakings	11.1	24.7	26	14.6	25.2	32.7	37.7	36.3
Economic Services	18.6	24.8	27.3	58.1	32.4	23.3	27.4	28.3
General Services	20.8	15	19.8	10.8	12.6	13.8	11.5	14.2
Interest receipts	39.6	26.5	18.3	10.7	20	17.9	13.5	11.5
Social & Community services	4.5	4.8	6	4.7	8	11.1	8.7	9
Union government								
Economic Services	10.2	13.2	24.5	62.5	31.8	31.8	34	32.7
Profits of RBI	8	14	17.8	10.9	18.2	29.4	32.4	29.4
Dividends & profits from NDUs	6.4	11.4	17.7	11	23.4	9.7	13	16
Interest receipts	66	52.8	26.1	9	16.6	15.1	11	12
General Services	4.3	4.3	8.8	4.4	5.8	7.4	5.9	6.8

Source (Basic Data): Indian Public Finance Statistics

Table 4.2 shows the share of main components of non-tax revenues in the total non-tax revenues for the central and state governments taken together. The contribution of general services and interest receipts has steadily fallen whereas that of public undertakings and economic services has increased over time. However, this may largely reflect that the amount of outstanding loans extended by the government may have come down and cumulated investment in public undertakings may have increased over time. As a number of recent Finance Commissions have recommended, norms of recovery rates for equity investment as well as outstanding loans need to be referred to in order to estimate the feasible potential revenue from these investments.

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[9] Srivastava, D. K., et al. "Budgetary subsidies in India: Subsidising social and economic services." *National Institute of Public Finance and Policy* (2003).

Home

Chapter 5

Budget 2017-18: Union Budget FY18 responds with mild stimulus to a sharp fall in growth (January 2017)

Abstract

This budget was preceded by the major initiative of demonetization of high value currency notes in India. It was being estimated that this would adversely affect the growth rate by 0.25-0.5 percentage points. Apart from demonetization, which was supposed to have a short-term impact, there were longer term constraints arising from a slowing down of investment demand and a weakening of global demand for India's exports. In this year, Brexit also happened and there were signs of the world economy entering into an era of 'de-globalization. This budget provided for a relatively higher growth for capital expenditure at 10.7% as compared to revenue expenditure growth of 5.9%. The structural budgetary reforms in favor of capital expenditure growth and containment of revenue expenditure growth through a reduction in subsidies and better targeting became clear in this budget.

Introduction

India's November 8 demonetization of high-denomination currency amounting to INR15.44 trillion i.e., 86.1% of the currency in circulation at that time, was by all accounts a disruptive economic move. Economic Survey 2016-2017 (herein after referred to as the Survey) estimates the extent of demonetization-linked erosion in GDP growth in FY17 to be in the range of 0.25-0.5 percentage points. This implies that the real GDP growth in FY17 would be in the range of 6.5-6.75%, given the growth rate of 7% for FY17 as estimated by the CSO without taking into account the effect of demonetization. Taken together, these imply a reduction in FY17 GDP growth in the range of 1.15-1.4 percentage points as compared to the growth of 7.9% achieved in FY16 as per the latest CSO release (31 January 2017). This 'demonetization dip' in the growth rate, as shown in Chart 6.1, can clearly qualify to be a 'far-reaching structural reform in the economy with unanticipated fiscal implications. The FRBM Review Committee has recommended that in the presence of such a structural reform, there would be a case for deviating from the fiscal deficit target of 3% of GDP. The Committee recommended a flexibility of up to 0.5 percentage points. This flexibility should be invoked if recommended by a '*fiscal council*'. It also suggested to anchor fiscal discipline to debt rather than the fiscal deficit relative to GDP. For the medium term, it suggested that the desired target should be a consolidated debt-GDP ratio of 60% of which 40% could be central debt and 20% could be consolidated state debt. Both these provisions provided enough justification for taking up a strong fiscal stimulus in the Union Budget of FY18 for uplifting India's economic growth closer to its potential, which the Survey quantifies to be in the range of 8-10%.

Constraints to India's growth

Apart from demonetization, which would have a short-term impact, there are longer term constraints emanating from a slowing down of investment demand and a weakening of global demand for India's exports. With the changed political situation in the US as also Brexit, the world economy is entering into an era of 'de-globalization' which would adversely affect India's growth prospects.

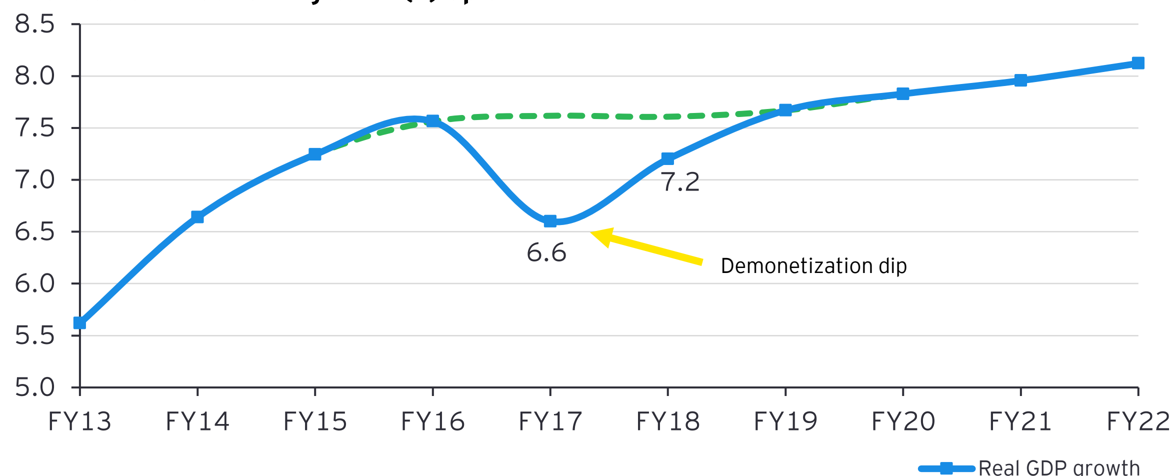
Table 6.1: Real GDP growth (%)

AD Component	2Q FY16	3Q FY16	4Q FY16	1Q FY17	2Q FY17	FY16	FY17
PFCE	6.3	8.2	8.3	6.7	7.6	7.3	5.5
GCE	3.3	3	2.9	18.8	15.2	2.9	26.5
GFCF	**9.7**	**1.2**	**-1.9**	**-3.1**	**-5.6**	6.1	0
EXP	**-4.3**	**-8.9**	**-1.9**	**3.2**	**0.3**	-5.4	2.2
IMP	**-0.6**	**-6.4**	**-1.6**	**-5.8**	**-9**	-5.9	-0.8
GDP *of which:*	7.6	7.2	7.9	7.1	7.3	7.9	7
% contribution of discrepancy	1.2	2.1	4.1	0.9	1.5	1.3	1.7

Source (Basic Data): MOSPI, Annual data has been taken from the CSO Release dated 31 January 2017

First, there is possibility of eruption of trade tensions amongst major countries, impacting India's exports. Second, there could be competition amongst major players in lowering corporate tax rates to attract capital. Third, with US incrementally uplifting the Fed rate, there would be steady pressure on the Indian rupee.

Chart 6.1: Annual GDP growth (%) up till FY22



Source (Basic Data): IMF

As Table 6.1 shows, gross fixed capital formation had started to contract in the last quarter of FY16. The magnitude of this contraction increased in the first and second quarters of FY17. Furthermore, CSO's latest release shows that even private final consumption expenditure slowed down considerably with an annual growth of 5.5% in FY17 compared to 7.3% in FY16. There were other indicators of the post-demonetization slowdown in terms of a sharp fall in bank credit growth and PMI for manufacturing and services which fell below the threshold of 50 in December 2016, indicating contraction.

Financing fiscal stimulus

The Economic Survey of 2016-17 also berated the rating agencies (Box 1, page 4, Economic Survey 2016-17,' Poor Standards? The Rating Agencies, China and India'). The Survey argues that India is very different from the comparators used by the rating agencies. India has a strong growth trajectory and has shown commitment to fiscal discipline. In fact, India might be able to carry much more debt than other countries. In other words, both the FRBM review committee and the observations of Economic Survey on the rating agencies created ground for the Finance Minister to retain fiscal deficit at 3.5% of GDP in FY18 same as in FY17 to support demand. However, he chose to allow for a minor increase by retaining fiscal deficit at 3.2% of GDP which could enable a growth of 10.7% in capital expenditure in FY18 (Table 6.2). Demand can also be additionally supported through various other channels. First, the government can access a one-time fiscal windfall linked to currency extinguishment which has not been factored in the Union Budget for FY18. The extent of this gain could be as much as 0.5% of GDP. Second, many states which are asking for a relaxation of their borrowing norms due to revenue erosion as a result of the slowdown can together be allowed an additional borrowing up to 0.5% of GDP. Borrowing 0.5 percentage points above the FY18 target of 3% of GDP would be justifiable noting that the consolidated government's debt-GDP ratio has fallen to 69% in 2015 from its peak of 84% in 2003. However, the Survey recognizes that the state finances are under stress with their consolidated fiscal deficit going up from 2.5% of GDP in 2014-15 to 3.6% of GDP in 2015-16, partly because of UDAY scheme.

Third, departmental enterprises such as posts and railways and non-departmental public enterprises can be persuaded to take up their expansion plans given the prevailing low prices of investment goods. Their borrowing, largely off-budget, can add another 0.5% of GDP to the fiscal stimulus. Together these channels could provide a stimulus amounting to 2.0% of GDP. Most of this stimulus should be directed towards augmenting infrastructure. Qualitatively, some push to construction, housing, and manufacturing particularly the automobile sector through sector specific incentives should help these demonetization-afflicted sectors.

Sequencing fiscal and monetary policy

As long as private investment demand remains weak, any interest rate reduction may not prove to be effective. Investment demand would pick up only after existing inventories are exhausted. At that point, monetary stimulus would become effective. The surge in bank deposits implying augmented financial savings would enable the government to borrow the extra amount without putting pressure on the interest rate. Fiscal stimulus, therefore, has to come first and it is best introduced by augmenting government's capital expenditure which would increase consumption demand in the economy. But, as indicated in Table 6.2, capital expenditure as percentage of GDP, is slated to fall in FY18.

Table 6.2: Expenditure performance and prospects

Expenditure head	FY16 (Act.)	FY17 (RE)	FY18 (BE)	FY17 (RE) over FY16 (Act.)	FY18 (BE) over FY17 (RE)	FY17 (RE)	FY18 (BE)
	INR lakh crore			Growth (%)		% of GDP	
Revenue expenditure *of which*	15.4	17.3	18.4	12.8	5.9	11.5	10.9
Interest payments	4.4	4.8	5.2	9.4	8.3	3.2	3.1
Pensions	1.0	1.3	1.3	32.4	2.4	0.9	0.8
Total subsidies *of which*	2.6	2.6	2.7	-1.4	4.5	1.7	1.6
Fertilizer subsidy	0.7	0.7	0.7	-3.3	0.0	0.5	0.4
Food subsidy	1.4	1.4	1.5	-3.0	7.5	0.9	0.9
Petroleum subsidy	0.3	0.3	0.3	-8.2	-9.2	0.2	0.1
Capital expenditure	2.5	2.8	3.1	10.6	10.7	1.9	1.8
Total expenditure	17.9	20.1	21.5	12.5	6.6	13.4	12.7

Source (Basic Data): Union Budget FY18

The Finance Minister, however, has left room for introducing additional fiscal stimulus as part of mid-term revision during the course of FY18 by observing that a final call on the matter will be taken after the recommendations of the FRBM Review Committee are examined in depth. In the context of monetary stimulus, the Survey observes that the room for it may be limited since domestic prices are expected to come under pressure due to increased prices of global crude and other primary articles. This has also been indicated by the RBI in its Monetary Policy Review in February 2017.

Realizing revised estimates for FY17

On the face of it, the Budget does not make excessively optimistic assumptions about tax revenue growth with an assumed buoyancy of just a little more than 1. In the case of non-tax revenues, the assumed growth is negative considering that the one-time surge in non-tax revenues due to spectrum sales would not be available in FY18. These growth rates must, however, be examined relative to the feasibility of their base numbers which are the revised estimates for FY17 which are based on data for 8 to 9 months of FY17. If we compare the full year magnitude of the revised estimates with the April-December cumulated magnitudes, the balance that is required to be realized is unduly large for some key variables. For instance, while in the first nine months, corporate tax revenues showed a growth of 4.8% over the corresponding period of the previous year, the growth required in the last quarter of FY17 is 17.7%. Similarly, in case of non-tax

revenues, the achieved growth was only 0.5% and the required growth in the last quarter is 118.5% if the revised estimates are expected to be realized. In case of disinvestments, realized revenue in the first 10 months was INR31,014 crore and the balance to be achieved in the remaining 2 months of FY17 is INR14,486 crore, which is nearly 50% of what has been realized in 10 months. There is thus reason to believe that there may be slippage in the revised estimates of revenue and non-debt capital receipts for FY17.

With respect to capital expenditure, considerable distance is to be covered in the last quarter of FY17 if the revised estimates are to be met. During April-December FY17, capital expenditure contracted by 3.8%. To realize the revised estimates, growth in 4QFY17 will have to be 52.1%.

Chapter 6

FRBM Review Committee: Proposing a new fiscal framework (May 2017)

Abstract

The 'in focus' write up of May 2017 focused on analyzing the recommendations of the FRBM review committee. The Review Committee submitted its four-volume Report titled "Responsible Growth: A Debt and Fiscal Framework for 21st Century India" on 23 January 2017, recommending the enactment of a new Debt Management and Fiscal Responsibility Bill (DMFRB) supplemented by Debt Management and Fiscal Responsibility Rules to replace the central government's FRBM Act, 2003, and FRBM Rules, 2004, including their subsequent amendments. The Committee had suggested a ceiling of general government debt at 60% of GDP. This is translated into ceilings of GDP for the Central and state governments at 40% and 20%, respectively. The Review Committee had also suggested a medium-term adjustment program to bring down fiscal and revenue deficits relative to GDP as also the constitution of a Fiscal Council. The critical features of the amended Act were first, introducing an asymmetry between central and state government debt targets relative to GDP and secondly providing an explicit counter cyclical clause.

Introduction

Following a commitment made in the Union Budget for FY17, an FRBM Review Committee was constituted on 17 May 2016. The Review Committee submitted its four-volume Report entitled "Responsible Growth: A Debt and Fiscal Framework for 21st Century India" on 23 January 2017, recommending the enactment of a new Debt Management and Fiscal Responsibility Bill (DMFRB) supplemented by Debt Management and Fiscal Responsibility Rules to replace the central government's FRBM Act, 2003, and FRBM Rules, 2004, including their subsequent amendments. The Committee has suggested a ceiling of general government debt at 60% of GDP. This is translated into ceilings of GDP for the Central and state governments at 40% and 20%, respectively. The Review Committee has also suggested a medium-term adjustment program to bring down fiscal and revenue deficits relative to GDP (Table 5.1) as also the constitution of a Fiscal Council.

Table 5.1: FRBM Review Committee Recommendations: Fiscal and Revenue Deficit Targets (% of GDP)

Fiscal year	FY18	FY19	FY20	FY21	FY22	FY23
Fiscal deficit	3.0	3.0	3.0	2.8	2.6	2.5
Revenue deficit	2.05	1.8	1.55	1.3	1.05	0.8

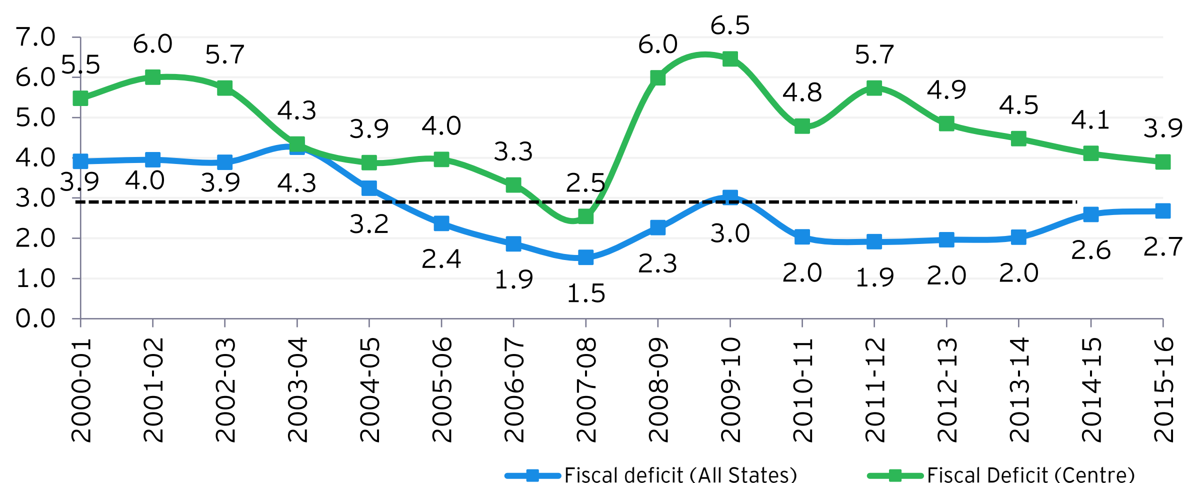
Source: Volume 1, FRBM Review Committee Report, 2017

The medium-term adjustment path is to be completed by FY23. The operational target of fiscal deficit is discontinued beyond that. Fiscal management beyond FY23 under the proposed DMFR Act is to be guided by only the debt-GDP ceilings. This implies that the fiscal deficit-GDP ratio for the union government can take any value as long as its debt-GDP ratio does not exceed 40%.

The context

The context in which the Review Committee was set up is characterized by three empirical features. First, after some initial success leading to an improvement in the debt and deficit profiles of the Central and state governments, the Central Government has kept postponing the targets envisaged in the existing FRBMA and the related Rules.

Chart 5.1: Fiscal deficit relative to GDP



Source (Basic Data): CAG, CGA, CSO

States, on the other hand, have been far more successful when considered together (Chart 5.1). Second, the values of the relevant parameters, relating, for example, to growth and inflation and the saving and investment ratios relevant for formulating the existing fiscal responsibility

framework, may have changed. Third, the existing FRBM does not provide for a clear countercyclical strategy. There is only an umbrella clause that is ambiguous and prone to misuse.

Examining the Review Committee's recommendations

There is an on-going debate as to whether the Review Committee has come up with recommendations that constitute a significant improvement over the existing FRBM and whether it can serve as an effective framework for guiding fiscal policy to usher in "responsible growth" within the constraints of fiscal discipline during the 21st century, as promised by the title of the report. First, there were significant differences within the Review Committee, signified by a strong minute of dissent by one of the committee members, Mr. Arvind Subramanian, who is Chief Economic Advisor, Ministry of Finance.

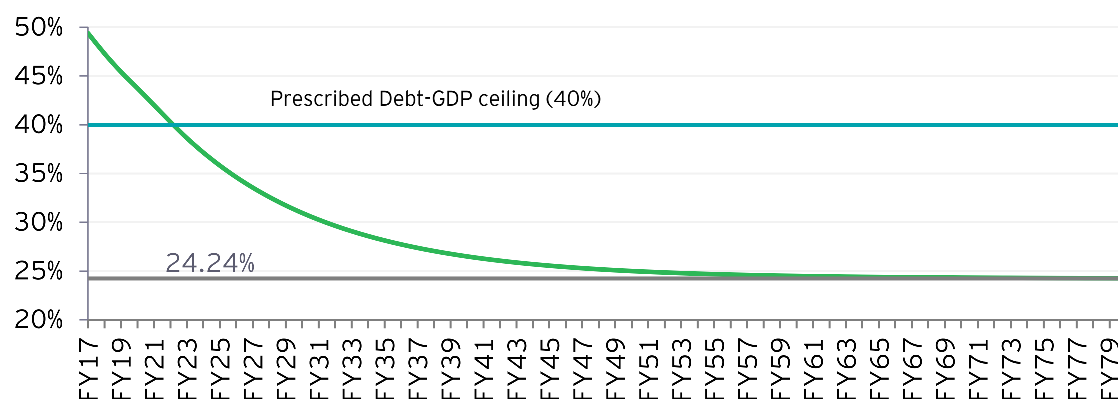
Following the publication of the FRBM review committee report, there has been a spate of commentaries on the recommendations. In a recent article (The Hindu, 28 April 2017), N.K. Singh, Chairman of the Review Committee, lists the difficulties that states will face in meeting the 20% debt-GDP ratio target as specified by the Review Committee. Rathin Roy (Business Standard, 13 April 2017) emphasizes why a Fiscal Council is important in the context of "a secretive governance culture like ours, where peripatetic decisions are commonplace." Sukumar Mukhopadhayaya (Business Standard, 30 April 2017) argues that the proposed Fiscal Council is superfluous and pernicious. M.S. Ahluwalia (The Mint, 28 April 2017) argues that the new Act should allow for adjustment of the medium-term fiscal deficit targets once every two years, to reflect revisions in the expected medium-term growth rate. Ajay Shah (Business Standard, 30 April 2017) and Datta and Pandey (The Wire, 17 April 2017) argue that any changes in the targets of the FRBM Act and Rules can be made through the route of a Money Bill, which needs to be passed by the Lok Sabha only. Shah advocates the inclusion of the fiscal responsibility rule in the Constitution itself. Jayati Ghosh (Frontline, online version, print edition, 12 May 2017) contends that rigid rules about debt-GDP targets, which are arbitrary in any case, "will unnecessarily constrain fiscal policies at a time when external circumstances and internal developmental goals both call for more flexibility." Indira Rajaraman (The Mint, 5 May 2017) points to inconsistencies between the debt-GDP targets and their corresponding steady state values. Further, she advocates the use of rainfall deficiency as a trigger for relaxation of borrowing targets rather than the ones proposed by the Review Committee. In a recent two-part contribution (Business Standard, 8 and 9 May 2017), Pronab Sen compares the relative merits of the analysis of the Review Committee and its recommendations vis-à-vis those in the minute of dissent. He suggests several modifications to the countercyclical strategy. Rangarajan and Srivastava (Business Line, 16 May 2017) suggest that there should be no rush to amend the existing law or push through a new bill until there is convincing evidence that India's financial savings have fallen for good. They recommend that first the reference values of debt and deficit should be made analytically consistent and brought in line with their sustainable values.

We consider here four aspects of the Review Committee's report: (a) role of the prescribed debt-GDP ratio as an anchor, (b) escape clauses and countercyclical policies, (c) role of states in overall fiscal policy and (d) instruments to improve implementation effectiveness.

a. Debt-GDP ratio as a ceiling

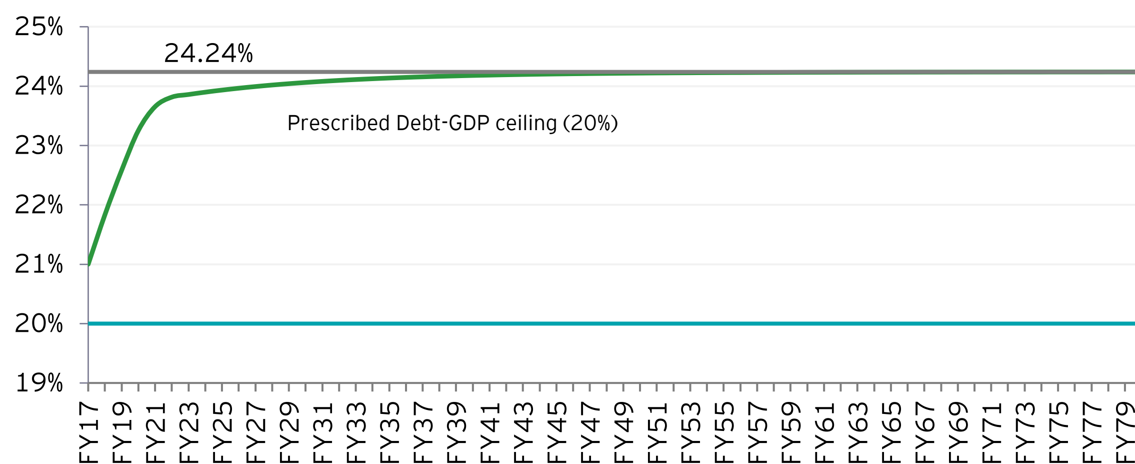
Considering the general government, the Review Committee has recommended the target values of debt and deficit levels relative to GDP to be achieved by FY23 as 60% and 5%. The corresponding numbers of the Central Government are 40% and 2.5% and for state governments, 20% and 2.5%. The prescribed debt-GDP ratios remain valid after FY23, but the fiscal deficit numbers do not. The underlying nominal growth is 11.5% and the available space for borrowing for the general government is 5% linked to the household sector's financial saving.

Chart 5.2: Evolution of union government's Debt-GDP ratio*



Source: Estimates based on Fiscal Deficit to GDP ratios specified by the Review Committee
*Under FRBM Review Committee assumptions and long-term general government borrowing of 5% of GDP

Chart 5.3: Evolution of states' Debt-GDP ratio*



Source: Estimates based on Fiscal Deficit to GDP ratios specified by the Review Committee
*Under FRBM Review Committee assumptions and long-term general government borrowing of 5% of GDP

While the Review Committee defines specific ceilings for the debt-GDP ratio at 40% and 20% for the union government and states, in the minute of dissent it is argued that the only requirement should be a continuous fall in the debt-GDP ratio.

In the case of the union government, for the defined reform path up to FY23, the debt-GDP ratios do continue to decline. In the case of states, however, if the principle of equal sharing of the borrowing space between the union government and the states, advocated by the Review Committee (p. 59, Volume 1) is followed, the debt-GDP ratio would steadily increase. In the case of the union government, the defined ceiling appears to lose relevance progressively if the fiscal deficit-GDP ratio beyond FY23 is kept at 2.5%. In the case of the states, the proposed debt ceiling of 20% never becomes relevant if equality between the fiscal deficits of the union government and all states is maintained. The convergence to their respective steady state or sustainable levels of the debt-GDP ratio is illustrated in Charts 5.2 and 5.3, starting with initial values of 49.4% and 21% for the union government and states respectively and using the fiscal deficit path specified by the Review Committee up to FY23. Beyond that, the fiscal deficit-GDP ratio is kept at 2.5% for the union government as well as the states. The difference in the prescribed ceiling values of the debt-GDP ratio and their corresponding steady state values have significant implications for the countercyclical strategy, and they also imply significant political economy risks close to future election years. These possibilities open up if beyond FY23, for most years, the fiscal deficit to GDP ratio is kept at 2.5% for the union government. The union government's debt-GDP ratio will keep

falling, moving further and further away from the prescribed debt-GDP ceiling of 40%. Then, a sudden upsurge in the fiscal deficit to GDP ratio can be undertaken without breaching the limit of 40%. This would be useful when responding to an economic slowdown but counterproductive if it is used close to future election years.

a. Escape clauses and counter-cyclical fiscal policy

The Review Committee has suggested certain "escape" clauses, where the Central Government can breach the path of fiscal deficit prescribed in the proposed bill. Such escape is permitted on account of (a) over-riding considerations of national security and acts of war, calamities of national proportion and collapse of agriculture severely affecting farm output and incomes, (b) far-reaching structural reforms in the economy with unanticipated fiscal implications and (c) decline in real output growth of at least 3 percentage points below its average of the previous four quarters. The first two clauses are qualitative in nature. These require an assessment of the prevailing economic conditions where the proposed Fiscal Council may play a role. Clause (c) adds a quantitative and verifiable guidance. The note of dissent emphasizes that the proposed escape clause could prove to be pro-cyclical. The proposed relaxation in the fiscal deficit limit cannot be initiated if the fall in the growth is less than 3 percentage points. If and when fiscal action is initiated for a large fall in growth rate, an extra fiscal deficit of only 0.5% of GDP may prove to be inadequate. In any case, this clause, although integral to the proposed Act, will have relevance only up to FY23, as the departure is defined only in relation to a fiscal deficit target and there is no fiscal deficit target beyond FY23 in the proposed Bill.

b. Role of states

The Review Committee does not envisage any role for the states in supplementing the union government's macro-stabilization efforts. The 0.5% departure is permitted only for the Central Government. Without coordinating their efforts with state governments in India, where some of the states are very large, the union government's stabilization efforts may prove to be less effective if the country faces any major economic slowdown.

c. Improving effectiveness of implementation

During the previous decade, the acceptance of the role of fiscal legislations to promote fiscal discipline increased significantly. The Central Government and progressively all the states enacted their fiscal responsibility legislations. Partly as a result of high growth, by 2007-08 significant progress was made toward achieving the desired targets. After that, a significant asymmetry in the fiscal performance of the union government and the states appeared. States as a whole and, with a limited number of exceptions, individually, continued to meet their FRL targets, and the Central Government continued to miss its own as pointed out in the 2016 CAG Report[10].

The main problem in implementing the existing union government's FRBMA has been lack of implementation teeth. First, in the union government's case, the fiscal deficit target is not part of the Act but only the Rules. The Rules also specify the rates of annual reduction of fiscal and revenue deficits. Being part of the Rules, these reduction rates and targets have been frequently revised through administrative orders. These changes then become part of the Budget, which being a Money Bill is required to be passed only by the Lok Sabha, although a discussion may happen in the Rajya Sabha. At the minimum, what is required is that the fiscal deficit target should become part of the Act rather than the Rules. Further, any departures from the borrowing targets should be discussed explicitly in the Parliament.

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[10]Report No. 27 of 2016, Department of Economic Affairs, Ministry of Finance, "Report of the Comptroller and Auditor General of India on Compliance of Fiscal Responsibility and Budget Management Act, 2003 for the year 2014-15"; Web link (accessed on 7 May 2017)
http://www.cag.gov.in/sites/default/files/audit_report_files/Union_Civil_Compliance_Report_27_2016_Full.pdf

Chapter 7
India's macro-economy on the eve of the FY19 Budget - Reinvigorating growth (January 2018)

Abstract

The FY19 Budget would be the NDA Government's fifth and last full-year budget during its term from May 2014 to May 2019. In FY18, a major change in India's tax structure was implemented through the introduction of GST in July 2017, affecting the government finances of FY18 and FY19. The economy had staged a recovery after a fall of growth rates for five consecutive quarters up to 1QFY17 following demonetization and the transition to GST. Given the turnaround in the growth momentum, the FY19 Budget may do well to strengthen this momentum through focused support to construction, infrastructure, housing and manufacturing. These sectors are not only job-intensive with the capacity to absorb both skilled and non-skilled labor but also have strong multiplier effects as they create demand for sectors such as cement, electricity and financial services.

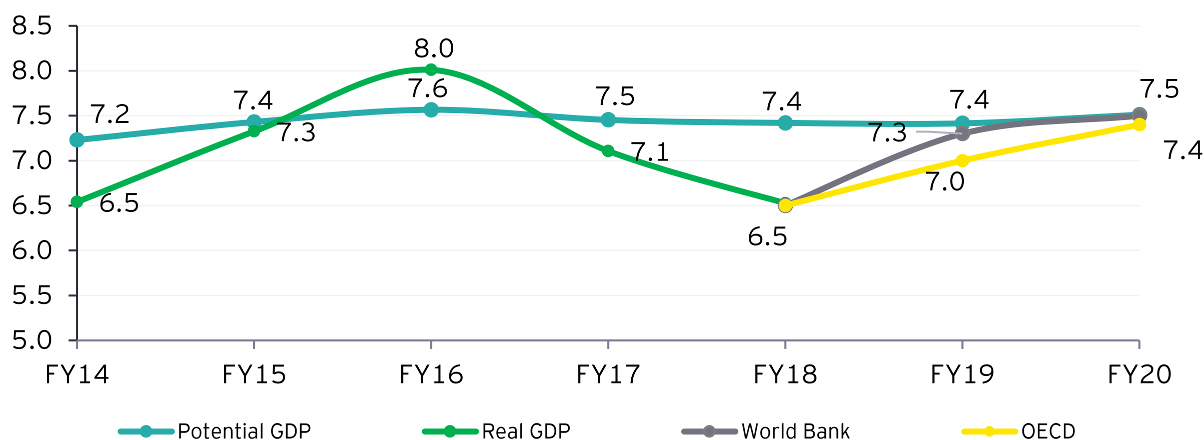
Introduction

The FY19 Budget would be the NDA Government's fifth and last full-year budget during its term from May 2014 to May 2019. As the economy stages a recovery after a fall for five consecutive quarters up to 1QFY17 following demonetization and the transition to GST, prospects of the FY19 Budget and India's recent macro-economic performance are integral to each other. Growth has staged a notable recovery from 2QFY18. Initiatives in the forthcoming Budget need to further energize the ongoing growth momentum.

Growth: Performance and potential

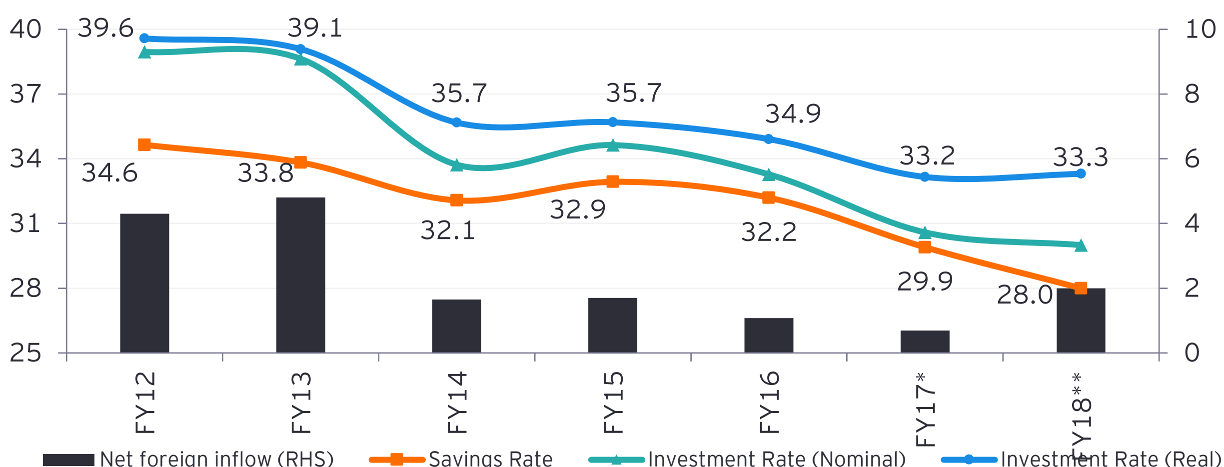
Achieved growth, in relation to its potential, indicates under-utilization of existing capacity. Although growth has staged a recovery in the first two quarters of FY18, it is still 1 percentage point below potential as per OECD's projections of India's potential growth. However, based on the ongoing recovery, both OECD and the World Bank have projected continued growth momentum for India at 7% and 7.3% respectively in FY19 (Chart 7.1).

Chart 7.1: India's GDP growth: Real and potential



Source (Basic Data): CSO, World Bank, OECD.
Note: real GDP growth up till FY18 has been sourced from the CSO.

Chart 7.2: India's saving and investment rates



Source (Basic Data): CSO, MOSPI.
*estimated; **estimates derived using first advance estimates of national income.

A longer-term growth issue is the steady fall in investment and saving rates. Capacity and therefore potential output depend on capital stock, which depends on investment. In India, investment is largely driven by domestic savings.

Measured as a % of GDP, savings fell from a peak of 34.6% in FY12 to 29.9% in FY17 relative to GDP (Chart 7.2). We estimate the saving rate to be close to 28% in FY17. The components of saving that are largely responsible for this fall are (a) domestic savings, particularly financial savings and (b) public sector savings. The policy challenge is to uplift potential output which requires accelerating investment financed largely by domestic savings.

There has been, however, one redeeming feature. The implicit price deflator for investment goods has remained lower than that of consumption goods since FY12. From FY13 to FY18, investment goods inflation, as measured by the implicit price deflator for GFCF at 2.6%, was only half of that for consumption goods at 5.2%. This has resulted in a higher investment rate in real terms as compared to nominal terms. In FY18, investment rate in real terms is estimated to be 33.3% compared to the nominal rate of 30%.

GDP components: Relative dynamics

Looking at GDP components, there are clear positive signs. Investment demand (GFCF), which had been falling up till 4QFY17, turned positive in 1QFY18 and improved to 4.7% in 2QFY18 (Table 7.1).

Table 7.1: Real GDP growth (%)

Component	4Q FY16	1Q FY17	2Q FY17	3Q FY17	4Q FY17	1Q FY18	2Q FY18	1H FY18	2H FY18 *
PFCE	11.8	8.4	7.9	11.1	7.3	6.7	6.5	6.6	6.1
GFCE	2.4	16.6	16.5	21.0	31.9	17.2	4.1	10.2	6.6
GFCF	3.9	7.4	3.0	1.7	-2.1	1.6	4.7	3.1	5.9
EXP	-1.6	2.0	1.5	4.0	10.3	1.2	1.2	1.2	7.6
IMP	-3.7	-0.5	-3.8	2.1	11.9	13.4	7.5	10.4	9.7
GDP	**9.0**	**7.9**	**7.5**	**7.0**	**6.1**	**5.7**	**6.3**	**6.0**	**7.0**
Contribution of net exports to growth (percentage points)	*0.5*	*0.5*	*1.2*	*0.4*	*-0.3*	*-2.6*	*-1.3*	*-2.0*	*-0.5*

Source: CSO, MOSPI; *derived

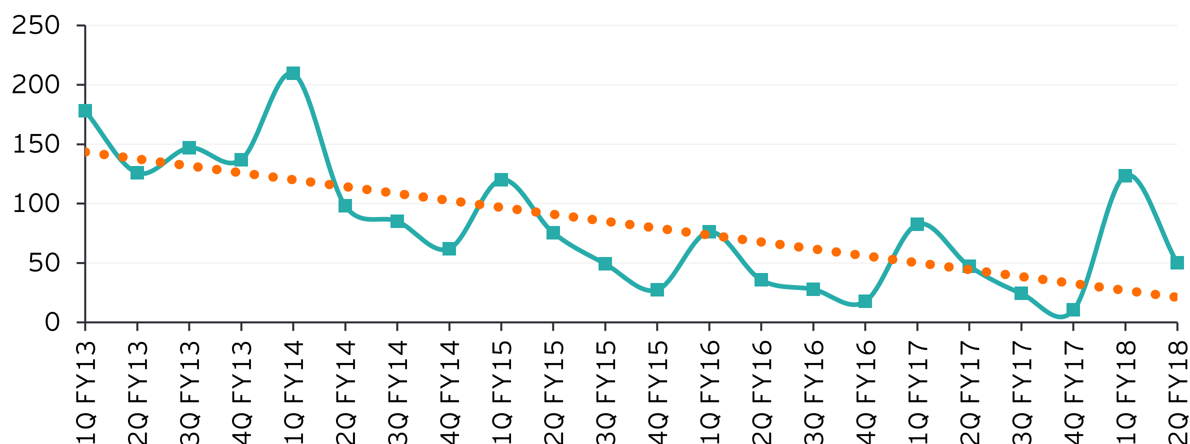
Momentum is building up as reflected in some high-frequency indicators. PMI manufacturing has remained above 50 for three consecutive months with the latest value being 54.7 in December 2017. PMI services and composite PMI recovered to 50.9 and 53 respectively in December. Credit growth, which had been languishing until recently, has picked up, showing a growth of 10.7% by December 2017.

Reducing macro imbalance: A significant achievement

A major achievement of the present Government during its term starting FY15 has been a steady reduction in macro imbalance. We measure macro imbalance by a combination of three indicators: fiscal deficit to GDP ratio, CPI inflation and CAD to GDP ratio. Their departure from a pre-defined norm indicates a macro imbalance. The summary indicator of macro imbalance is an equally weighted sum of these three components, namely, percentage deviation of inflation rate (based on new CPI 2011−12=100), fiscal deficit (as a percentage of GDP) and CAD (as a percentage of GDP) from their respective benchmarks of 4% of GDP, 3% of GDP and 1.3% of GDP. The state of “balance”

is judged by a value of "0." An index value > 0 indicates the presence of an imbalance in the economy[11]. The higher the value, the greater the extent of imbalance. With all the three components of IMI close to their respective benchmarks, the economy moved to a near full macro balance for the second time since 4QFY12. A major success of the policymakers in recent years has been to bring the economy closer to a situation of macro balance as shown in the Chart 7.3.

Chart 7.3: Index of macro imbalance



Source: EY analysis.

Overall CPI inflation has remained below its benchmark value of 4% for four quarters in a row. In the pre-NDA years (FY13 and FY14), CPI inflation was in the range of 8%-11%. This has been brought down to levels below 4% partly due to the focus of the Monetary Policy Committee (MPC) on inflation management and partly due to a fall in crude prices until recently. In FY13, the union government's fiscal deficit (CFD)-GDP ratio was as high as 4.9%. It has been steadily brought down to a level close to 3.2% depending on the outcome of the FY18 figures. In FY13, CAD as a % of GDP was at a significantly high level of 4.8%. Since then, it gradually reduced to reach 0.7% in FY17.

Evolving policy legacy

In the macro context, the evolving policy legacy of the NDA Government, focused as it is on structural and supply side reforms, will provide strong foundations for future growth. It needs to be acknowledged that demand management has been highly constrained for the Government because of legacy issues.

The NDA Government inherited both a high level of inflation and a high level of fiscal deficit to GDP ratio. In addition, from FY16, 42% of the union government's shareable tax revenues started to be transferred to the states under the recommendations of the 14th Finance Commission. Bringing these to their desired levels left little room for demand side management. The NDA Government's policy has been focused on supply side reforms, aimed at increasing the productivity of resources. With monetary policy being handled by the MPC and the fiscal side being heavily constrained, the Central Government focused on supply side reforms based on legislation and regulation. GST, for example, is very largely a supply side policy reform as it aims to improve the productive efficiency of the economy by better resource allocation, removal of inter-jurisdiction fiscal barriers and bringing in supply chain efficiencies. Improved regulatory policies including the new bankruptcy law, the FRBMA in its current or potentially modified form and RERA are examples of the institutional and regulatory reforms. A number of government welfare programs such as Jan Dhan Yojana, crop insurance and accident insurance involved minimum budgetary cost but required extensive private participation.

[11] In considering the percentage deviation of each of the indicators from its selected norm, only the positive deviations are taken. Negative deviations are equated to zero to ensure that the negative and positive deviations across indices are not canceled out.

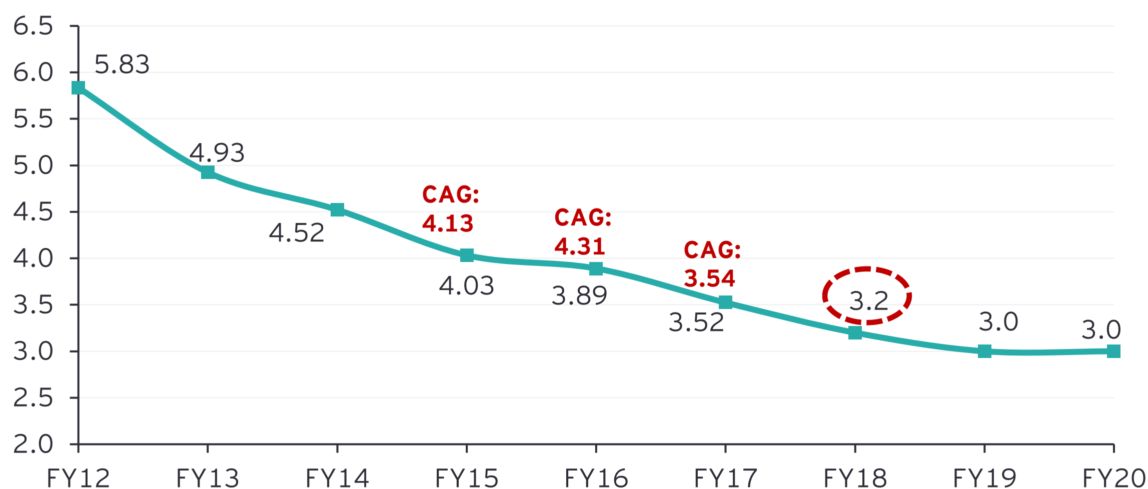
A positive trend in the era of the present Government has been the creation of additional fiscal space of more than 2 percentage points of GDP during FY14—FY17 from (a) a reduction in the budgetary subsidies to GDP ratio of about 1percentage point and (b) an increase in the union government's gross tax to GDP ratio of 1.2 percentage points. Expenditure reforms should be continued in the FY19 Budget by downsizing ministries dealing with state subjects.

Budget prospects: Continued adherence to fiscal discipline

Indications are that there may be some slippage in achieving the budgeted targets for both tax and non-tax revenues. Customs duty revenues, excise duty revenues from POL products and GST revenues may fall short of the budgeted targets. By November 2017, non-tax revenues amounted to only 36% of the budgeted target. Although the RBI is likely to top up its already announced dividend to the Government by about INR 13,000 crore, there might still be a shortfall in non-tax revenues. The expected shortfall in receipts would leave the Government with a difficult choice. It would need to consider either allowing the fiscal deficit to slip beyond the target of 3.2%, thereby compromising on its reputation for maintaining fiscal discipline, or cutting expenditure, thus dampening the ongoing growth momentum (Charts 7.4 and 7.5). Given the Government's commitment to fiscal consolidation and some improvement in revenue prospects, the slippage in the fiscal deficit, if any, may be kept to a minimal. Furthermore, the Government may make up for any lost ground in FY19 by sticking to the target of 3% of GDP as per the consolidation path as revenue prospects are likely to improve in FY19. An ambitious disinvestment program for FY19 is already taking off, with the Government already planning strategic disinvestment in about 36 companies in FY19. Also, by that time, GST would have normalized and become compliance-friendly and is likely to improve direct tax compliance. If petroleum products are brought within the GST ambit, they would also become ad-valorem, giving buoyancy to government revenues as global crude prices firm up. There are indications that imports are rising and import duties might also show more buoyancy. Furthermore, the RBI dividends would also normalize as the fall in FY18 in these dividends was largely due to demonetization. With an expected increase in real GDP growth at over 7.3% and likely inflation at about 4.5%, the Government may not be unjustified in using a nominal growth assumption of close to 12% in FY19.

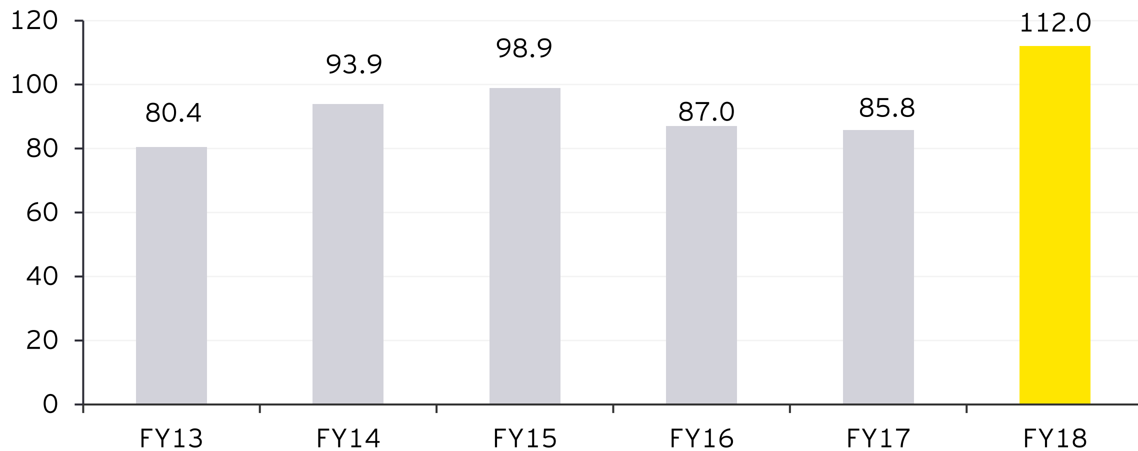
Fiscal deficit: Possibilities and challenges

Chart 7.4: Fiscal roadmap (fiscal deficit as a % of GDP)



Source (Basic Data): Data up till FY17 has been taken from CGA, CAG Report on Union Government's finance accounts for FY15, FY16 and FY17 and medium -term fiscal policy statement, Union Budget FY17 and FY18.

Chart 7.5: Fiscal deficit during April-November 2017 as a % of annual budgeted estimates for FY18



Source (Basic Data): Monthly accounts, CGA.

Given the turnaround in the growth momentum, the FY19 Budget may do well to strengthen this momentum through focused support to construction, infrastructure, housing and manufacturing. These sectors are not only job-intensive and have the capacity to absorb both skilled and non-skilled labor but also have strong multiplier effects as they create demand for sectors such as cement, electricity and financial services. A significant challenge arises from the rural and agricultural economy, which has proved to be vulnerable as the farmers suffer from output and price shocks. In both cases, the resultant is an income shock. Although the farmers have the least capacity to face such volatility, they are subject to considerable income volatility. In order to ensure that their incomes do not fall below a defined minimum threshold, a suitable farmer income insurance scheme may be designed financed by subscriptions by farmers, insurance companies and the Government. This would be fiscally far more feasible than a universal basic income program.

Chapter 8
Budget 2018-19: Demand-based stimulation to growth (February 2018)

Abstract

The underlying thrust of Budget FY19 was to stimulate growth by supporting aggregate demand. This was achieved by putting forward an ambitious spending program that was to be financed by both budgetary and extra-budgetary resources. Budget FY19 also included the amendment to the FRBM Act of 2003. The amended act gave up revenue account balance as a target while providing asymmetric targets for debt for the central and state governments as well as a departure from the 3% fiscal deficit to GDP target under its countercyclical clauses. In this writeup, we assessed that there would be a positive impact on growth through the demand stimulation introduced by Budget FY19. The growth impetus was through supporting sectors, such as infrastructure, construction, agriculture and health, which are job-creating sectors and had high multiplier effects.

Introduction

The underlying thrust of Budget FY19 is to stimulate growth by supporting aggregate demand. This has been achieved by putting forward an ambitious spending program that is to be financed by both budgetary and extra-budgetary resources. We look at Budget FY19 for (a) highlighting the key contours of the Budget, (b) policy thrust areas for budgetary support, (c) financing of outlays by budgetary and extra-budgetary resources, (d) amendment of the FRBM Act and (e) the growth outlook in the light of these budgetary developments.

Key contours of Budget FY19

The revised fiscal deficit estimate for FY18 in comparison to the corresponding budget estimate is higher by INR48,317 crore. This is on account of additional government expenditure pushing aggregate demand in the system. It favors current expenditures rather than capital expenditures and allows for realistic revenue-sided adjustments (Table 8.1). Increase in aggregate demand by additional government expenditure has a growth-supporting role.

Table 8.1: Fiscal deficit arithmetic

Head/Year	FY17 (Act.)	FY18 (BE)	FY18 (RE)	FY19 (BE)	Deviation FY18 (RE - BE)
	Amounts in INR lakh crore; percent to GDP				INR crore; % points to GDP
Revenue expenditure	**16.91**	**18.37**	**19.44**	**21.42**	**107,371**
% to GDP	11.08	10.90	11.58	11.44	0.64
Capital expenditure	**2.85**	**3.10**	**2.73**	**3.004**	**-36,356**
% to GDP	1.87	1.84	1.63	1.60	-0.22
Net tax revenues	**11.01**	**12.27**	**12.69**	**14.806**	**42,440**
% to GDP	7.22	7.28	7.56	7.91	0.25
Non-tax revenues	**2.73**	**2.89**	**2.36**	**2.451**	**-52,783**
% to GDP	1.79	1.71	1.41	1.31	-0.31
Fiscal deficit	**5.36**	**5.47**	**5.95**	**6.243**	**48,317**
% to GDP	3.51	3.24	3.54	3.33	0.29
Non-debt capital receipts ***of which***	**0.65**	**0.84**	**1.17**	**0.922**	**33,040**
Disinvestment	**0.48**	**0.73**	**1.00**	**0.800**	**27,500**
Memo					
Revenue deficit	**3.16**	**3.21**	**4.39**	**4.160**	**117,714**
% to GDP	2.07	1.91	2.61	2.22	0.70
GDP (nominal)	**152.54**	**168.47**	**167.85**	**187.22**	**1,67,84,679**

Source (Basic Data): Union Budget documents and MoSPI

The structure of expenditure shows a significant push to aggregate demand if we look at total expenditures excluding interest payments and pensions, which are in the nature of transfer payments. Non-pension primary expenditure in the RE of FY18 at 9.2% of GDP is 0.3 percentage points higher than the actuals of FY17 (Table 8.2). This reflects an overall push to demand.

Table 8.2: Union government's expenditure — steady increase in revenue expenditure

Head/Year	FY17 (Act.)	FY18 (BE)	FY18 (RE)	FY19 (BE)	Deviation FY18 (RE - BE)
	Amounts in INR lakh crore; % to GDP				INR crore; % to GDP
Revenue expenditure	16.91	18.37	19.44	21.42	1,07,371
% to GDP	11.08	10.90	11.58	11.44	0.64
Interest payments	4.81	5.23	5.31	5.76	7,825
% to GDP	3.15	3.10	3.16	3.08	0.05
Pensions	1.31	1.31	1.47	1.68	16,186
% to GDP	0.86	0.78	0.88	0.90	0.10
Subsidies of which	2.35	2.73	2.64	2.93	-8,781
% to GDP	1.54	1.62	1.57	1.56	-0.05
Non-pension primary expenditure	13.63	14.93	15.40	16.98	47,004
% to GDP	8.94	8.86	9.17	9.07	0.28
Capital expenditure	2.85	3.10	2.73	3.004	-36,356
% to GDP	1.87	1.84	1.63	1.60	-0.22

Source (Basic Data): Union Budget documents and MoSPI

In terms of capital expenditure undertaken through the Central Government's Budget, there has been a progressive decline from FY17, when it was 1.87% of GDP. It fell to 1.63% in FY18 (RE) and is further budgeted at 1.65 % of GDP in FY19. However, we note that the Government undertakes considerable capital expenditure through public sector enterprises that is financed by internal and extra budgetary resources (IEBR).

Table 8.3: Tax buoyancy

Head/Year	FY17 (Act.)	FY18 (BE)	FY18 (RE)	FY19 (BE)	Deviation FY18 (RE-BE)
	Amounts in INR lakh crore, % to GDP				INR crore; % points to GDP
Gross tax revenue	17.16	19.12	19.46	22.71	34,540
Buoyancy	*1.65*	*1.04*	*1.34*	*1.45*	*0.21*
Direct tax *of which*	8.50	9.80	10.05	11.50	25,000
Buoyancy	*1.14*	*1.33*	*1.82*	*1.25*	*0.15*
Corporation tax	4.85	5.39	5.64	6.21	25,000
Buoyancy	*0.62*	*0.77*	*1.62*	*0.88*	*0.15*
Taxes on income	3.65	4.41	4.41	5.29	0.00

Head/Year	FY17 (Act.)	FY18 (BE)	FY18 (RE)	FY19 (BE)	Deviation FY18 (RE-BE)
	Amounts in INR lakh crore, % to GDP				INR crore; % points to GDP
Buoyancy	*1.99*	*2.12*	*2.09*	*1.72*	*0.00*
Indirect taxes*	**8.6**	**9.3**	**9.4**	**11.2**	**9475**
Buoyancy	*1.99*	*0.75*	*0.86*	*1.66*	*0.06*
Nominal GDP growth	***10.82***	***11.75***	***10.04***	***11.54***	

Source (Basic Data): Union Budget 2018-19; NAS - MOSPI, EY Analysis.

There is an improvement in direct tax buoyancy reflected in FY18 (RE) (Table 8.3). This is largely attributable to both personal income taxes where buoyancy has improved steadily since FY17. For corporation income tax, buoyancy improved only in FY18 (RE). In FY18 (RE), disinvestment proceeds were not only at their highest level historically but also exceeded the Budget estimates by a significant margin (Table 8.4).

Table 8.4: Disinvestment receipts – target and achievement (INR crore)

Disinvestment	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Target (BE)	55,814	63,425	69,500	56,500	72,500	80,000
Actual/RE	29,368	37,737	42,132	47,743	100,000 (RE)	-
Achievement (as a % of target)	52.6	59.5	60.6	84.5	137.9	-

Source: Department of Investment and Public Asset Management, GoI.

Policy thrust areas for budgetary support

The sectors receiving additional priority through central and centrally sponsored schemes in the Budget expenditure of FY19 are housing, transport and agriculture (Table 8.5). These reflect the Government's sectoral priorities. These sectors are known to have high multiplier effects, and additional purchasing power being imparted to these sectors is likely to have both a direct and an indirect positive impact on growth.

Table 8.5: Relative importance of central sector and centrally sponsored schemes (percent to total revenue expenditure)

Head/Year	FY16	FY17	FY18 (RE)	FY19 (BE)
General services *of which*				
Other general services	2.46	1.15	1.05	1.04
Social services *of which*				
General education	2.59	2.45	2.26	2.25
Medical and public health	1.54	1.59	1.86	1.76
Housing	0.11	1.13	1.02	1.11
Other social services	3.48	3.43	3.95	3.90
Economic services *of which*				

Head/Year	FY16	FY17	FY18 (RE)	FY19 (BE)
Agriculture	1.32	2.49	2.20	2.28
Rural development	5.14	5.82	5.80	5.50
Energy	0.45	0.73	0.89	0.85
Industry and minerals	7.33	2.41	2.61	2.27
Transport	0.24	0.71	0.59	0.84
Other economic services	10.82	12.61	12.52	13.04
Total*	35.48	34.52	34.76	34.84
Total (INR lakh crore)	5.46	5.84	6.76	7.46

Source (Basic Data): Union Budget 2018-19, EY analysis.

Financing of outlays by budgetary and extra-budgetary resources

Total outlays for three focus areas of the Government – namely, agriculture and rural livelihoods, infrastructure and education, health and social sectors – for FY19 amount to 11.6% of GDP (Table 8.6). These are to be funded by both budgetary and extra budgetary resources. The Government has used the budgetary resources to leverage much larger extra budgetary resources for these sectors. In the case of agriculture and rural livelihood programs, the leverage factor, calculated as total outlay upon budgetary support, is 6.1 and in the case of infrastructure, it is 3.8. This implies an extremely large push to demand financing activities in these sectors relative to the budgetary resources utilized for these purposes.

Table 8.6: Role of budgetary and extra budgetary resources – FY19

S. no.	Sector/Heads	GBS (INR crore)	EBR (INR crore)	Total outlay (INR crore)	Total outlay as a % of GDP
1	Agriculture and rural livelihood programs	236,127	1,198,190	1,434,317	7.7
1.1	*% of total outlay*	*16.5*	*83.5*		
2	Capital outlay on infrastructure	157,208	439,935	597,143	3.2
2.1	*% of total outlay*	*26.3*	*73.7*		
3	Schematic outlays for Education, Health and Social Protection Sectors	NA	NA	137,981	0.7
4	Total outlay			2,169,441	11.6

Source: Annexure I, Annexure II, Annexure III, Budget speech of Union Finance Minister 2018-19.

Fiscal risks may also be higher with the greater reliance on extra-budgetary resources for financing a number of the ambitious government spending programs. In the Budget for 2018-19, total outlays for the three focus areas of the Government amount to 11.6% of GDP as per Annexures 1,2 and 3 of the Finance Minister's speech. These are to be funded by both budgetary and extra-budgetary resources. Budgetary resources constitute only 16.4 % of the total outlay for agriculture and rural livelihood programs. The balance of 83.6% is to be raised as extra-budgetary resources by the concerned public sector enterprises, special purpose vehicles and other similar institutions. Thus, the extra-budgetary resources are meant to contribute nearly 9.7% of GDP to finance the stipulated outlays as detailed in the Annexures to the Finance Minister's speech. A substantial part of this may be based on borrowing as the relevant bodies may have only limited surpluses. Any dependence on borrowing for these extra-budgetary resources along with the borrowing requirements of the state governments while the saving rate is falling can potentially put considerable pressure on the interest rate.

Amendment of the FRBM Act

a. Resetting the fiscal responsibility framework

After the enactment of the FRBM Act in 2003 and the related FRBM Rules in 2004, the target fiscal deficit to GDP ratio of 3% for the union government was achieved only once, in the year 2007-08, when it was 2.5% of GDP. Since then, that target has not been achieved again. The FRBM Act was amended in 2012 and again in 2015. The revisions in 2015 shifted the date for achieving the 3% target to 2017-18. By this year, the amended revenue deficit target was put at 2% of GDP.

Budget 2018-19 has proposed to amend the FRBM Act again. This amendment shifts the target of 3% fiscal deficit-GDP ratio to end-2021. The revenue deficit target has been given up altogether. The new statutory anchors relate to the general and Central Government debt-GDP ratios that are to be reduced to 60% and 40% of GDP by 2024-25, based on the recommendations of the report of the FRBM Review Committee headed by N.K. Singh. However, only a modified version of their recommendations has been accepted.

b. Implications of continuously revising targets

As per the requirement of the FRBM Act of 2003, as amended in 2015, a medium-term fiscal policy statement has been presented by successive governments in each budget giving three-year rolling targets for fiscal deficit, revenue deficit, effective revenue deficit and outstanding debt of the Central Government. A review of these rolling targets and corresponding achievements highlights that these targets for all the four variables could not be achieved. Thus, with reference to the new anchor of the union government's debt-GDP ratio, the target set in the 2015-16 Budget was 42.8% for 2017-18. In the 2016-17 budget, it was reset to 46.8%. The RE for 2017-18 show the debt-GDP ratio at 49.1%. Thus, the deviation of the target from the FY18 (RE) was 6.3 percentage points of the GDP when it was first set; and even after resetting in the next year, it was 2.3 percentage points. There was only one exception when the target of 3.5% for 2016-17 set in 2015-16 equaled the corresponding realization. However, in the 2017-18 (RE), we have remained at the 3.5% level.

The average annual rate, in terms of percentage points, at which different governments have reduced the fiscal and revenue deficits relative to GDP has been quite low. The average annual rate of reduction over two different regimes, namely, from 2009-10 to 2013-14 and 2014-15 to 2018-19, for fiscal deficit relative to GDP was 0.3 percentage points per year in the first period and 0.2 percentage points per year for the second period. The same margins applied for revenue deficit reduction. For the union government's debt-GDP ratio, the average reduction margin was 1.1 percentage points and 0.5 percentage points per year for the two periods, respectively. The current Budget has retained fiscal deficit at 3.5% of GDP, missing the budgeted target of 3.2% of GDP, which was itself a deviation from the stipulated target of 3% of GDP for 2017-18 in the amended FRBM Act. A slippage margin of 50 basis points implies a delay in reaching the debt-GDP target of 40% by two-and-a-half years given the average margin of reduction of 0.2 percentage points per year. With the absence of improvement in the fiscal deficit level in 2017-18, the debt-

GDP ratio has increased to 49.1% in 2017-18 from 48.7% in 2016-17 rather than falling, which was the trend until recently.

c. Modifying the review committee recommendations

In the proposed amendment to the FRBM Act, a number of key recommendations of the Review Committee were not accepted. First, the Review Committee had recommended the target at which the fiscal deficit to GDP ratio was to be stabilized at 2.5%. The Review Committee had derived the 2.5% target by reference to the annual estimate of available investible resources at 10% of GDP consisting of surplus savings of the household sector and sustainable net capital inflows. They assessed that half of it, that is, 5%, could be pre-emptively shared equally by the Central and state governments, keeping their fiscal deficits at 2.5% of GDP each, leaving the balance of 5% for the public sector and corporate borrowing. Since then, the available surplus savings of the household sector may have fallen further. However, the Government chose to continue with the 3% target. If this was to be the case, we might as well have continued with the present FRBM Act. In fact, it can be shown that if the Government were to abide by the 3% mandate beyond 2020-21, the debt to GDP ratio will come down to 40% by 2024-25 with a nominal GDP growth assumption of 11.5%. Thus, specifying the fiscal deficit target of 3% would have been enough to achieve the debt target.

Second, the Review Committee had not given up on the desirability of achieving revenue account balance. It had specified a revenue deficit glide path, reaching 0.8% by 2022-23. This was also not accepted. The target of revenue account balance is well recognized in the so-called "golden rule" wherein a country may borrow as long as the entire borrowing is used for capital spending. This can only be achieved by keeping revenue deficit to zero. In the Indian context, revenue deficit with some adjustments reflects government dis-savings. Unless government dis-savings are eliminated, it might be difficult to reverse the trend of a falling saving rate.

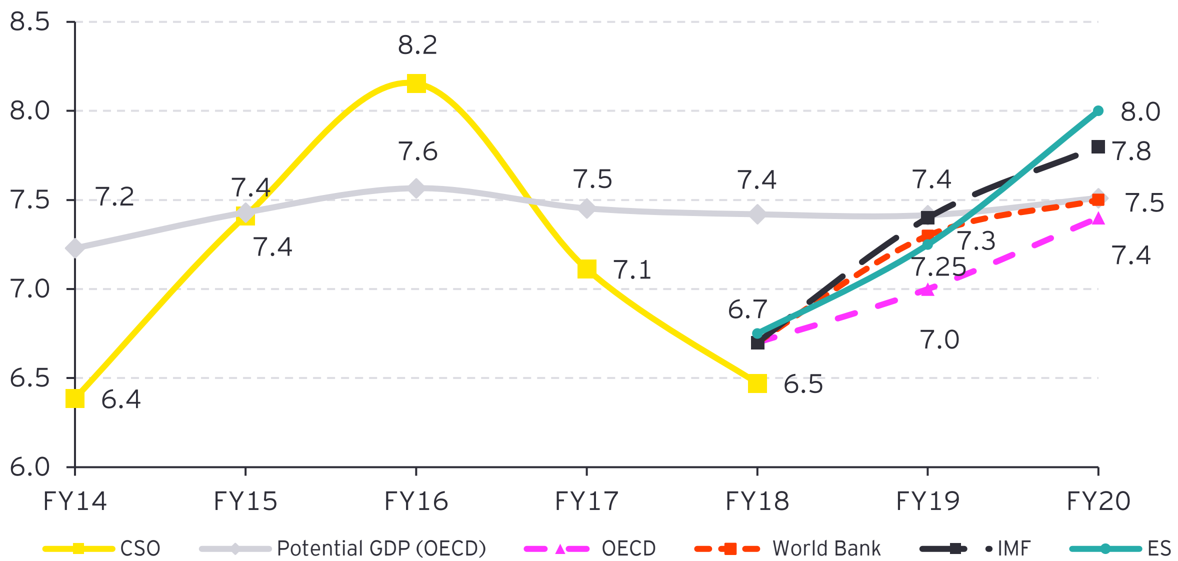
Third, the Central Government also did not accept the recommendation of the Review Committee to set up a Fiscal Council, which could independently examine the economic case and justification for deviating from the specified targets. Unconstrained fiscal flexibility both in approach and statutory provisions adds to a climate of avoidable fiscal risks.

Fourth, the debt-GDP levels of 60% and 40% of GDP for the general and Central governments were to be achieved by 2022-23 in the Committee's recommendations. These target dates have been shifted to 2024-25.

d. Growth outlook

The temporary effects of demonetization and GST transition are firmly behind us. A strong recovery started from 2QFY18. The World Bank and the IMF project a 7.3%–7.4% growth rate for FY19 and a growth close to 8% in two to three years (Chart 8.1). The Budget FY19 and its demand stimulation would support this growth impetus through directly supporting sectors such as infrastructure, construction, agriculture and health, which are job-creating sectors and will have multiplier effects.

Chart 8.1: India's GDP growth: — actual vs. potential



Source (Basic Data): National Accounts Statistics, Ministry of Statistics and Programs Implementation; OECD; World Bank; Economic Survey 2017-18, Ministry of Finance, Government of India.

The IMF projected a strongly positive outlook for global growth, which would support India's export demand. Export growth strengthened in 2HFY18. Private investment demand has started to improve from 1HFY18. Although private and government consumption expenditure showed a slight deceleration in 2HFY18, these trends are likely to be reversed soon because of the strong demand push being introduced through the budget.

Chapter 9

Interim Budget 2019-20: Assessing the progress of fiscal reforms (February 2019)

Abstract

General elections were scheduled to be held in May 2019. The GoI had to come up with an interim budget in February 2019. We utilized this occasion to take account of the impact of fiscal reforms undertaken during 2015 to 2019. This entire period was characterized by an emphasis on reducing fiscal deficit to bring it in line with the Fiscal Responsibility and Budget Management Act (FRBMA) target despite the impact of the sharp increase in states' share of central taxes following the recommendations of the Fourteenth Finance Commission from 32% to 42%. In this interim budget, the government continued to stimulate demand through several measures. First, in the form of direct transfers to farmers, a budgetary commitment for INR20,000 crore in FY19 and INR75,000 crore in FY20 was provided. This was to serve as relief to small and marginal farmers to the extent of INR6,000 per year per farmer. Secondly, the standard deduction for salaried employees was raised from INR40,000 to INR50,000. Third, a tax relief was to be given to low to middle income groups with a taxable income of less than INR5 lakh. This relief was to be claimed as a rebate.

Introduction

By providing FY19 revised estimates (RE), the interim budget for FY20 of the union government offers an opportunity to take stock of the progress of fiscal reforms over the last five years. Further the FY20 budget estimates (BE) indicate the direction of fiscal reforms and commitments for the next year.

Progress of fiscal reforms

In order to review the progress of fiscal reforms during the period from FY15 to FY19 (period 2), it may be useful to make a comparison with the corresponding averages during the previous five year period covering FY10 to FY14 (period 1). In Table 9.1, we consider the average magnitudes of important fiscal aggregates in period 2 relative to period 1.

Table 9.1: Fiscal aggregates-budgetary balance (as a % of GDP)

	GTR	NetTR	NTR	NetRR	NDCR	FD
FY10	9.8	7.2	1.8	9.0	0.5	6.6
FY11	10.4	7.5	2.9	10.3	0.5	4.9
FY12	10.2	7.2	1.4	8.6	0.4	5.9
FY13	10.4	7.5	1.4	8.8	0.4	4.9
FY14	10.1	7.3	1.8	9.0	0.4	4.5
FY15	10.0	7.2	1.6	8.8	0.4	4.1
FY16	10.6	6.9	1.8	8.7	0.5	3.9
FY17	11.2	7.2	1.8	8.9	0.4	3.5
FY18	11.2	7.3	1.1	8.4	0.7	3.5
FY19 (RE)	11.9	7.9	1.3	9.2	0.5	3.4
Period 1 (avg.)	***10.2***	***7.3***	***1.8***	***9.2***	***0.4***	***5.4***
Period 2 (avg.)	***11.0***	***7.3***	***1.5***	***8.8***	***0.5***	***3.7***
Period 2 minus 1	***0.8***	***0.0***	***-0.3***	***-0.4***	***0.1***	***-1.7***

Source (Basic data): Union Budget documents and MOSPI
Note: Abbreviations used are as follows: GTR – gross tax revenues, NetTR-Net tax revenue, NTR-Non-tax revenue, NetRR-Net Revenue Receipts, Non-debt capital receipts-NDCR, FD-Fiscal deficit

The outstanding feature in period 2 is the emphasis on reducing fiscal deficit so as to bring it in line with the Fiscal Responsibility and Budget Management Act (FRBMA) target despite the impact of the sharp increase in state's share of central taxes following the recommendations of the Fourteenth Finance Commission from 32% to 42%. Comparing the average of period 2 vis-à-vis period 1, it is evident that fiscal reforms from FY15 to FY20 resulted in the reduction of fiscal deficit relative to GDP by 1.7 percentage points (Table 9.1). This reduction in fiscal deficit is not due to revenue side gains. In fact, comparing the average of period 2 to period 1, there is a positive gain in the gross tax revenue to GDP ratio by a margin of 0.8 percentage points. But this gain was neutralized by an increase in the share of states in central taxes from 32% to 42% in FY16 following the recommendations of the 14th Finance Commission. As a result, the gain in union government's net tax revenue to GDP ratio was nil. Furthermore, non-tax revenues relative to GDP actually fell by a margin of 0.3 percentage points. This was partially balanced by a small increase in non-debt capital receipts to GDP ratio.

Table 9.2: Deficit and debt as a % of GDP

	Revenue deficit	Fiscal deficit	Primary deficit	Debt	RD/FD	CE/FD
	As a % of GDP				Ratio	
FY10	5.3	6.6	3.2	55.4	81.0%	26.9%
FY11	3.3	4.9	1.8	51.6	67.5%	41.9%
FY12	4.5	5.9	2.8	51.7	76.4%	30.7%
FY13	3.7	4.9	1.8	51.0	74.3%	34.0%
FY14	3.2	4.5	1.1	50.5	71.0%	37.3%
FY15	2.9	4.1	0.9	50.1	71.6%	38.5%
FY16	2.5	3.9	0.7	50.1	64.3%	47.5%
FY17	2.1	3.5	0.4	48.4	59.1%	53.1%
FY18	2.6	3.5	0.4	48.2	75.1%	44.5%
FY19 (RE)	2.2	3.4	0.2	48.1	64.8%	49.9%
Period 1 (avg.)	*4.0*	*5.4*	*2.2*	*52.0*	*74.1%*	*34.2%*
Period 2 (avg.)	*2.5*	*3.7*	*0.5*	*49.0*	*67.0%*	*46.7%*
Period 2 minus 1	*-1.5*	*-1.7*	*-1.7*	*-3.1*	*-7.1%*	*12.5%*

Source (Basic data): Union Budget documents and MOSPI

The burden of reducing the fiscal deficit therefore fell almost entirely on the expenditures. As Table 9.3 shows, this was largely driven by a fall in union government's revenue expenditure relative to GDP by a margin of 1.9 percentage points . This in turn was due mainly to a fall in government subsidies relative to GDP by a margin of 0.7 percentage points. This was driven by subsidy reforms aimed at better targeting through the direct benefit transfer schemes. Comparing the last year of period 1 when the debt to GDP ratio stood at 50.5%, to the year 2018-19 which is the last year of period 2, this was brought down, although only marginally to 48.1% (Table 9.2).

Table 9.3: Union government's expenditure as a % of GDP

	IP	Pensions	SS	RE	CE	TE
FY10	3.3	0.9	2.2	14.3	1.8	16.1
FY11	3.1	0.8	2.3	13.6	2.1	15.7
FY12	3.1	0.7	2.5	13.1	1.8	14.9
FY13	3.1	0.7	2.6	12.5	1.7	14.2
FY14	3.3	0.7	2.3	12.2	1.7	13.9
FY15	3.2	0.8	2.1	11.8	1.6	13.3
FY16	3.2	0.7	1.9	11.2	1.8	13.0
FY17	3.1	0.9	1.5	11.0	1.9	12.9
FY18	3.1	0.9	1.3	11.0	1.5	12.5
FY19 (RE)	3.1	0.9	1.6	11.4	1.7	13.0
Period 1 (avg.)	3.2	0.7	2.4	13.2	1.8	15.0
Period 2 (avg.)	3.2	0.8	1.7	11.3	1.7	13.0
Period 2 minus Period 1	0.0	0.1	-0.7	-1.9	-0.1	-2.0

Source (Basic data): Union Budget documents and MOSPI
Notes: Abbreviations used are as follows: IP-Interest Payments, SS-Subsidies, RE-Revenue expenditure, SS-Subsidies, CE-Capital expenditure, TE-Total expenditure

Capital expenditure relative to GDP also fell by a small margin of 0.1 percentage points in period 2 as compared to period 1.

As Table 9.4 indicates, comparing periods 1 and 2, the fall in petroleum subsidies by 0.4 percentage points was the largest, followed by a fall of 0.3 percentage points in fertilizer subsidies. In both these cases, there is a link with petroleum prices. As such this reduction in the subsidy amounts relative to GDP was facilitated by the fall in the global crude prices during FY16 onwards.

Table 9.4: Subsidies as a % of GDP

	Major subsidies	Fertilizer subsidy	Food subsidy	Petroleum subsidy
FY10	2.1	1.0	0.9	0.2
FY11	2.2	0.8	0.8	0.5
FY12	2.4	0.8	0.8	0.8
FY13	2.5	0.7	0.9	1.0
FY14	2.2	0.6	0.8	0.8
FY15	2.0	0.6	0.9	0.5
FY16	1.8	0.5	1.0	0.2
FY17	1.3	0.4	0.7	0.2
FY18	1.1	0.4	0.6	0.1
FY19 (RE)	1.4	0.4	0.9	0.1

	Major subsidies	Fertilizer subsidy	Food subsidy	Petroleum subsidy
Period 1	*2.3*	*0.8*	*0.9*	*0.7*
Period 2	*1.5*	*0.5*	*0.8*	*0.2*
Period 2 minus 1	*-0.7*	*-0.3*	*0.0*	*-0.4*

Source (Basic data): Union Budget documents and MOSPI

Performance of taxes

Recognizing that tax reforms also played a critical role in the overall fiscal reforms, we have examined the performance of major individual taxes. In the case of personal income tax, the revenues as a percentage of GDP increased by a margin of 0.4 percentage points in period 2 as compared to period 1. Most of this increase was due to the expansion of the tax base where the number of people filing returns increased significantly from 3.5 crore in FY15 to 5.4 crore in FY18[12], showing a growth of about 55%. In the case of corporation tax however, there is a fall by a margin of 0.4 percentage points during the same period. The NDA government had announced a target to reduce the corporate income tax rate from 30% to 25%. Although this was introduced only partially, this may have had an impact on the corporate tax revenues.

Table 9.5: Tax revenues as a % of GDP

	DT	CIT	PIT	IDT			GTR
				Customs	Domestic IDT	Total	
FY10	5.9	3.8	2.1	1.3	2.6	3.9	9.8
FY11	5.8	3.9	1.9	1.8	2.8	4.5	10.4
FY12	5.7	3.7	1.9	1.7	2.8	4.5	10.2
FY13	5.6	3.6	2.0	1.7	3.1	4.8	10.4
FY14	5.7	3.5	2.2	1.5	2.9	4.5	10.1
FY15	5.6	3.4	2.1	1.5	2.9	4.4	10.0
FY16	5.4	3.3	2.1	1.5	3.7	5.2	10.6
FY17	5.5	3.2	2.4	1.5	4.2	5.6	11.2
FY18	5.9	3.3	2.5	0.8	4.6	5.4	11.2
FY19 (RE)	6.4	3.6	2.8	0.7	4.9	5.6	11.9
Period 1	5.7	3.7	2.0	1.6	2.8	4.4	10.2
Period 2	5.7	3.4	2.4	1.2	4.0	5.2	11.0
Period 2 minus 1	0.0	-0.4	0.4	-0.4	1.2	0.8	0.8

Source (Basic data): Union Budget documents and MOSPI

In the case of indirect taxes, a major reform was the implementation of GST in 2017. Since this brought about a change in the composition of indirect taxes, it is difficult to compare revenue performance of individual taxes with the pre-GST years. As such we are looking at the aggregate

[12] https://www.incometaxindia.gov.in/Documents/Direct%20Tax%20Data/Income-tax-statistics-i-t-return-ay-2017-18-v1.pdf

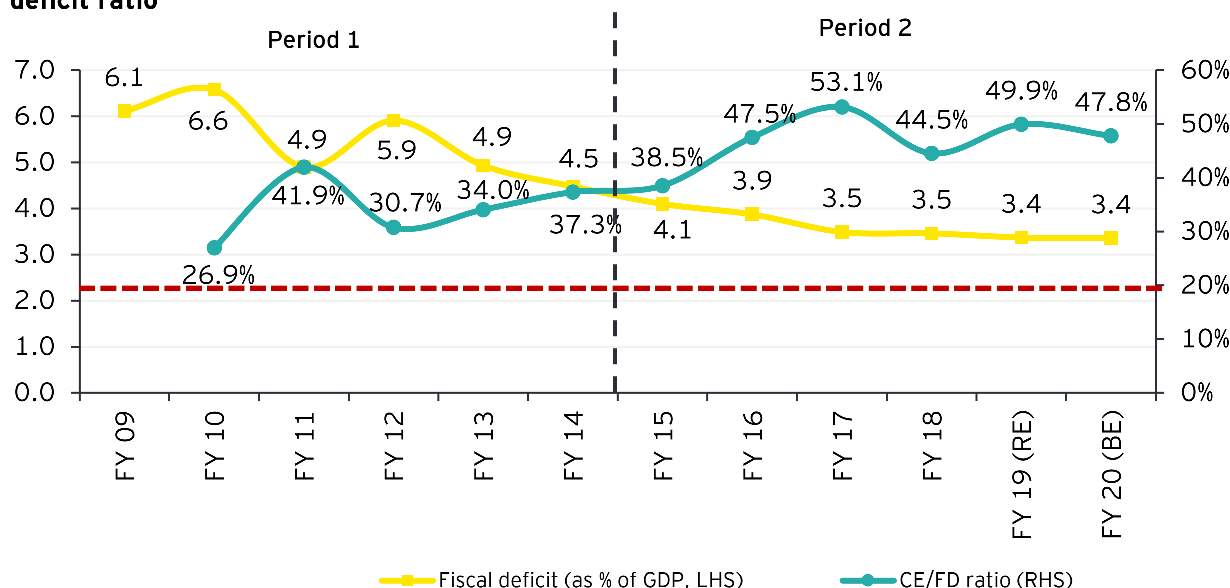
category of domestic indirect taxes which relative to GDP show an increase of 1.2 percentage points in period 2 as compared to period 1 (Table 9.5). Much of this happened from FY16 when the global crude prices had dipped to a significant extent thereby creating room for the central government to increase the specific component of the union excise duty on petroleum products.

Improvement in fiscal balance: Future course

We note that even by FY19, the government could still not achieve the FRBMA target of 3% of GDP (Chart 9.1) although the quality of fiscal deficit improved. Measuring quality of fiscal deficit by considering the portion of borrowing that goes for financing capital expenditure, it may be noted that in period 1 on average, this ratio was 34.2%. It improved to 46.7% in period 2, that is, an improvement of 12.5 percentage points.

Considering that in the FY20 budget estimates, the fiscal deficit to GDP ratio is budgeted at 3.4%, the FRBMA target still appears to be at some distance. The glide path of fiscal deficit given in the medium-term fiscal policy cum fiscal policy strategy statement reflects a sudden reduction in fiscal deficit to GDP from 3.4% in FY20 to 3.0% in FY21 in one go.

Chart 9.1: Union government's fiscal deficit to GDP ratio and capital expenditure to fiscal deficit ratio



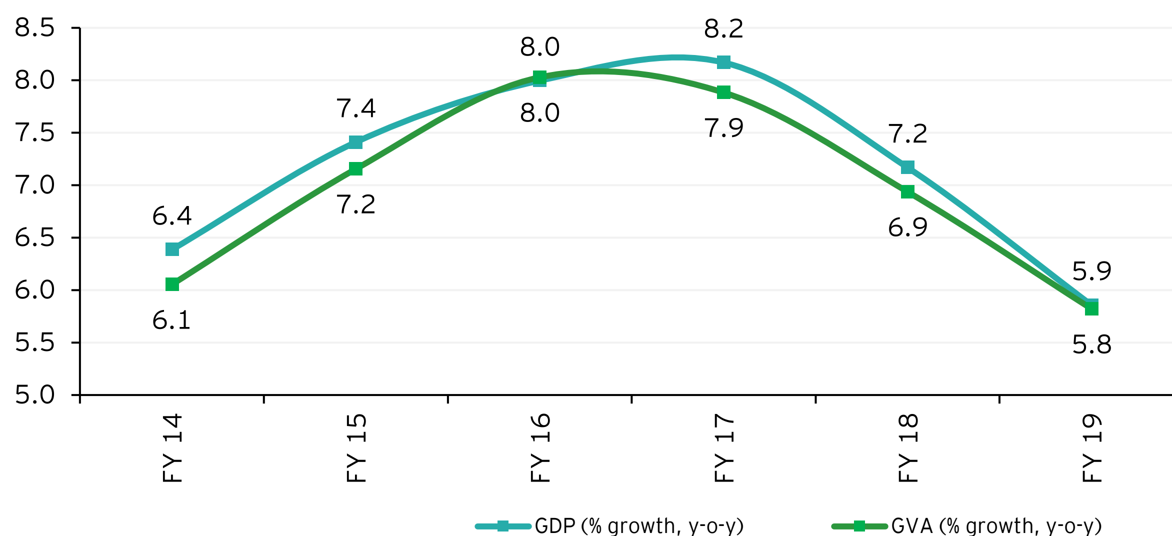
Source (Basic data): Union Budget documents and MOSPI

Achieving this would require considerable improvement on the revenue side of the budget as the room for adjustment on the expenditure side is very narrow. There is however a possibility of revision of the GDP numbers when the provisional estimates for FY19 are announced which might have implications on fiscal aggregates measured relative to GDP.

GDP at current prices: Revision in provisional estimates may be critical

The FY20 budget uses nominal GDP magnitude which is the same as that given in GDP Advance Estimates (FY19) that were released by the CSO on 7th January 2019. However, the real and nominal GDP estimates were significantly changed in the first revised estimates of GDP for FY18, which was released a day prior to the presentation of the budget FY20 (Table 9.6). Since the budget has used the advanced estimates of nominal GDP, the implied sharp fall in real GDP growth to less than 6% in FY19 (Chart 9.2) may be revised which may in turn modify all budgetary parameters measured as a ratio of GDP. This may imply a fall in fiscal deficit to GDP ratio from 3.4% in FY19 as also a fall in the capital expenditure to GDP ratio from 1.6%.

Chart 9.2: Real GDP and GVA growth



Source (basic data): MOSPI

Table 9.6: Nominal GDP

Year	CSO	As per 2019-20 BE	Growth
	INR crore		% annual
FY14	112,33,522		13.0
FY15	124,67,959		11.0
FY16	137,71,874		10.5
FY17	153,62,386		11.5
FY18	170,95,005		11.3
FY19	188,40,731	188,40,731	10.2
FY20		210,07,439	11.5

Source (basic data): MOSPI, Union budget 2019-20

Observations on FY19 revised estimates and FY20 budget estimates

The interim budget projections for FY20 as compared to the FY19 RE show a reasonable growth rate in gross tax revenues of 13.5%. However, the FY19 RE is dependent on achieving a growth rate of 17.2% in the union government's gross tax revenues. This high growth rate is shown in spite of the fact that in the case of GST revenues, as compared to the budgeted amount, a shortfall of INR100,000 crore is shown in FY19 RE.

Table 9.7: Growth and buoyancy of union government's tax revenues

	DT	CIT	PIT	Total IDT	Domestic IDT	GTR
Growth in central tax revenue (% ann)						
FY18	17.9	17.8	18.1	5.9	23.0	11.8
FY19 (RE)	19.8	17.5	22.8	14.3	16.5	17.2
FY20 (BE)	15.0	13.3	17.2	11.8	11.8	13.5
FY20 (BE) minus FY 19 (RE)	-4.8	-4.2	-5.6	-2.5	-4.7	-3.6
Buoyancy of central taxes						
FY18	1.6	1.6	1.6	0.5	2.0	1.0
FY19 (RE)	1.9	1.7	2.2	1.4	1.6	1.7
FY20 (BE)	1.3	1.2	1.5	1.0	1.0	1.2

Source (Basic data): Union Budget documents and MOSPI

The shortfall in GST revenues is made up by increasing the budgeted corporate tax revenues by a margin of INR. 50,000 crore. According to the latest CGA release, in the first nine months during April-December FY19, corporate tax revenues accounted for 63.7% of the 2018-19 revised estimates. In the remaining three months, the corporate tax revenues need to grow by 24.2% over the corresponding period of the previous fiscal to achieve the revised estimates for the full year. The corresponding growth in corporate tax revenues in the January-March period for the last four years (FY15 to FY18) on average was only 10.2%. In the case of personal income tax, there is no change in the revised estimates compared to the budget estimates. During the period from April-December FY19, income tax revenues accounted for only 57.1% of the revised estimate for FY19. Here, the growth required in the January-March period to achieve the full year target is 55.5%. In comparison, the corresponding growth achieved on an average during the last four years is only 15.2%. Thus, in both the cases, the projected growth rates in the revised estimates appear to be much above the average performance in recent years.

Furthermore, in the case of GST compensation cess, the budgeted amount is equal to the revised amount at INR90,000 crore. However, the budgeted transfer to the compensation fund during FY19 is only INR51,735 crore. This leaves an amount of INR38,265 crore with the central government which eventually will have to be transferred to the compensation fund. In fact, the government has taken credit of a large amount of dividends from the RBI. It is INR74,140 crore for FY19 RE which is INR19,323 crore more than what was budgeted. Further, RBI dividends for FY20 have been budgeted at INR82,912 crore which is nearly 85% more than the actual dividends from the RBI in FY18.

Expenditure side of the Budget: Fiscal stimulus

The government has introduced a number of measures to stimulate demand in the economy. First, in the form of direct transfers to farmers, a budgetary commitment for INR20,000 crore in FY19 and INR75,000 crore in FY20 has been provided. This is to serve as relief to small and marginal farmers to the extent of INR6,000 per year per farmer. Secondly, the standard deduction for salaried employees has been raised from INR40,000 to INR50,000. Third, a tax relief has been given to low to middle income groups with a taxable income of less than INR5 lakh. This relief is to be claimed as a rebate. These programs are likely to add to the private disposable incomes of low to middle income segments. They have the potential of raising consumption demand in the economy since the relatively lower income groups tend to have a higher marginal propensity to consume. This fiscal stimulus is likely to have a tangible positive effect on growth. Its impact on the inflation rate may be limited under the current circumstances since food inflation in January 2019 was

contracting at (-) 2.2% y-o-y and the overall CPI inflation was quite low at 2.0%. At the moment global growth prospects are also considered somewhat subdued (IMF 2019, World bank 2019)[13]. The global crude prices therefore are not expected to show any major sustained upward pressure. It may however be noted that stimulus brought through increasing capital expenditure would have been desirable since India's investment rate has been falling in recent years.

[13] Global growth is projected at 2.9% in 2019, a downward revision of 0.1% points (World Bank Global Economic Prospects January 2019). IMF (World Economic Outlook update January 2019) has also revised down the global growth projection by 0.2% points to 3.5% in 2019.

Chapter 10

Has the union government's fiscal marksmanship improved over time? (May 2019)

Abstract

In May 2019, just before the presentation of the final budget of FY20 by the new government, we undertook an analysis of GoI's budgetary marksmanship and noticed a clear improvement in it over time. GoI's gross taxes had been overestimated throughout the period from FY01 to FY18, but the magnitude of percentage error had come down noticeably in recent years. In the case of non-tax revenues, percentage errors were relatively high in recent years. In the case of revenue expenditures, the predictive quality of estimates deteriorated over time. The revenue expenditures were generally overestimated. In the case of fiscal deficit, we found that the number of years of overestimation of BE were more than the number of years of underestimation. Overall, the quality of the union government's fiscal marksmanship appears to have improved. This may be partly the consequence of the need to adhere to the FRBMA targets.

Introduction

In the FY20 interim budget, for a number of items, the budget estimates were revised sharply. Available information indicates that even the revised estimates, particularly on the revenue side, may differ from the actuals tangibly. The capacity of the Ministry of Finance (MoF) to make accurate forecasts of key fiscal aggregates determines the quality and efficacy of its fiscal marksmanship. While policy variables such as the tax rates are known in advance, the tax bases depend on how the economy performs. The revenue side of the budget is therefore an interplay of policy parameters and market forces. The expenditure side is largely discretionary because the expenditures can be budgeted and spent entirely on government's discretion. However, in this case also, since governments are involved in procurement of goods and services, the nominal value of the purchases undertaken by the government depends on the prevailing prices. Furthermore, even though the MoF collects information from various ministries and departments in order to prepare the budget, actual expenditures depend on the capacities of individual departments to complete budgeted expenditures while remaining consistent with the prescribed and due processes. Ever since the central government subjected itself to Fiscal Responsibility and Budget Management Act (FRBMA) targets, it has an obligation to meet the prescribed targets and explain if there are any deviations. Governments have shown keenness to adhere to or come close to the pre-announced fiscal deficit estimates and in cases where the revenue side underperforms, governments tend to make adjustments on the expenditure side.

There is a view in the literature that after the introduction of FRBMA, government's fiscal marksmanship might have improved[14]. It is useful therefore, from time to time, to review the quality of government's fiscal marksmanship by analyzing the quality of budget and revised estimates as predictors of the corresponding actuals. With a view to undertake such an analysis, we have reviewed the predictive quality of the budget and revised estimates of the union government's budget with respect to major fiscal aggregates covering revenue, expenditure and fiscal imbalance variables over a period of 18 years from FY01 to FY18. For convenience, we have divided these periods into four sub-periods as detailed in Table 10.1.

Table 10.1: Sub-periods for analysis

Period 1	Period 2	Period 3	Period 4
2000-01 to 2003-04	2004-05 to 2008-09	2009-10 to 2013-14	2014-15 to 2017-18

We have evaluated the quality of forecasts by looking at the direction of error (overestimation or underestimation) and its extent as measured by percentage error in budget estimates (BE) and revised estimates (RE) relative to budget actuals (BA). The sequence of analysis is to cover the fiscal aggregates relating to revenues, expenditures and then fiscal imbalances.

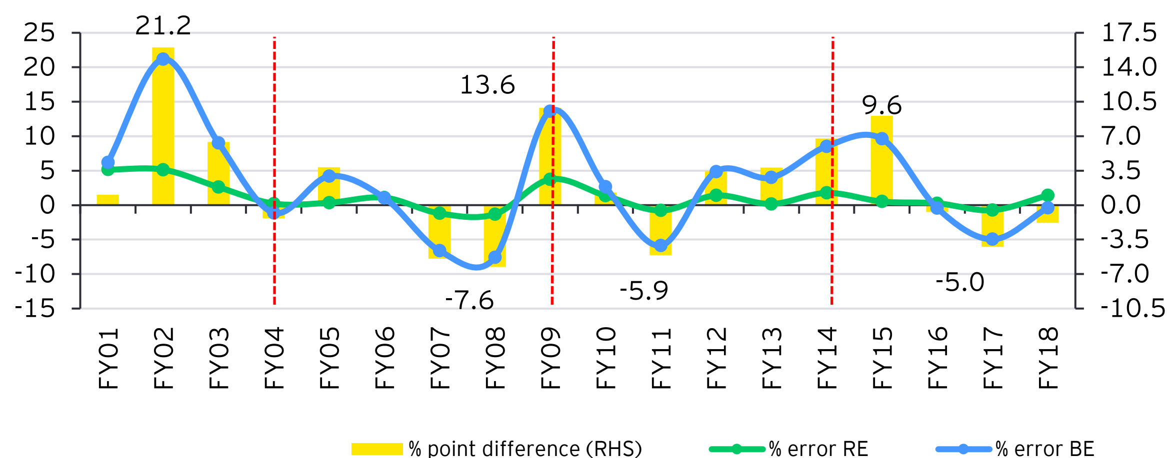
The government gets one opportunity to improve its marksmanship when the revised estimates (RE) are presented. Until recently, the central budgets were presented at the end of February. Since the fiscal year started in April, the budget was presented only one month in advance of the fiscal year. With effect from FY18 budget, the presentation of the budget was brought forward to end-January/ beginning of February so that the estimates were made two months ahead of the beginning of the fiscal year. At the time of the presentation of the budget, RE for the current fiscal year are also presented. The end-February budget presentation enabled the utilization of actual data from the CGA up to December covering a period of nine months of the fiscal year so that estimates were required only for a period of three months. After the budget presentation was brought forward, BE have to be prepared two months in advance and RE have to use estimates for four months.

[14] Chakraborty, L. S., & Sinha, D. (2018). Has Fiscal Rules changed the Fiscal Behavior of Union Government in India? Anatomy of Budgetary Forecast Errors in India. *International Journal of Financial Research*, *9*(3), 75-85.

Revenue aggregates

Chart 10.1 shows the percentage error in BE and RE relative to the actuals for union government's gross tax revenues. The position of the percentage error line above the horizontal axis shows cases of overestimation. Between the four regimes considered here, on average, there is an overestimation of union government's taxes in all the four periods. However, it was particularly pronounced in periods 1 and 3. The revised estimates provide a significant improvement in the quality of projection. The average errors in the BE and RE over the four periods with respect to the gross tax revenues and its major components are summarized in Table 10.2.

Chart 10.1: Union government's gross tax revenues: % error relative to actuals



Source (basic data): Union Budget documents, various years

Table 10.2: Union government's gross tax revenues and major components: average % errors in RE and BE

Period	GTR		NetTR		CIT		PIT		IDT	
	RE	BE	RE	BE	RE	BE	RE	BE	RE	BE
Period 1	3.3	8.8	4.0	9.2	2.8	4.8	4.3	12.0	4.7	11.3
Period 2	0.5	0.9	0.7	0.9	0.9	0.3	12.5	10.3	0.7	3.1
Period 3	0.8	2.8	1.1	3.1	1.1	5.7	-0.2	-6.5	1.2	5.0
Period 4	0.4	1.0	0.5	0.02	-0.04	1.3	1.4	5.0	-8.1[#]	-8.7[#]

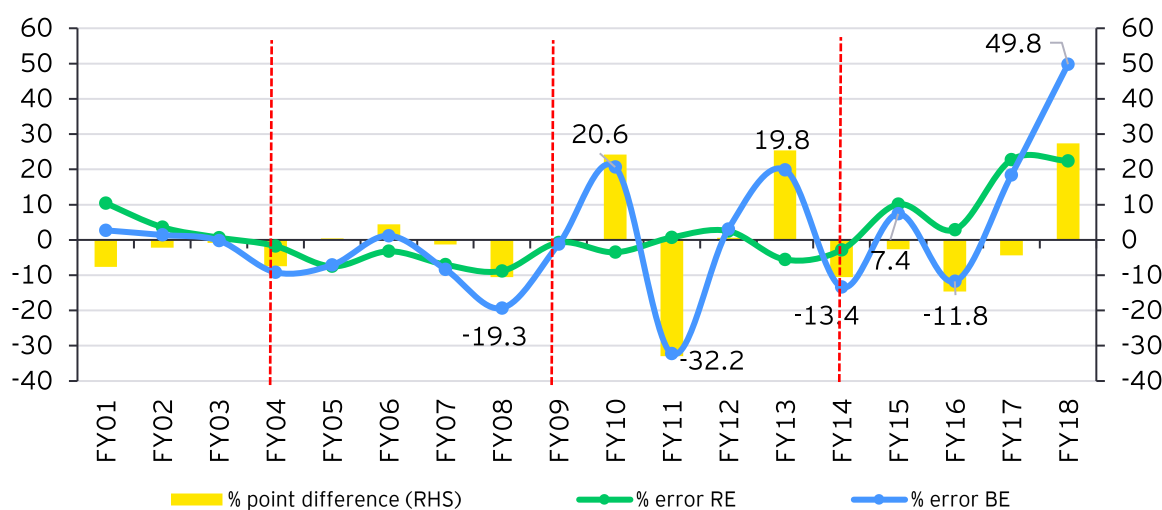
Source (basic data): Union budget documents, various years
*total indirect taxes include union excise duties, customs duties, service taxes, taxes of UTs and union government's GST revenues in FY18
#average % error in period 4 excluding FY18 is -0.6 for RE and -1 for BE

On the revenue side, we have looked at union government's gross tax revenues and three of its major components namely, corporate and personal income taxes and total indirect taxes. Once states' share in central taxes are set aside, we get union government's net tax revenues. In all cases, apart from two exceptions, throughout this period, taxes were overestimated. The magnitude of overestimation of BE was close to 9% in union government's gross taxes in period 1. It improved considerably in period 2 and period 4 when the margin of error on an average was close to 1%. The RE remained overestimates in most cases but the margin of error was significantly lower. In fact the lowest margin of error was observed in period 4 when it is only 0.4% of the

actuals. In the case of union government's net taxes, the margins of errors were marginally higher than in gross taxes except for BE of period 4. In terms of direct taxes, the predictive quality of budget estimates is much better for CIT as compared to PIT. The average % error is also relatively high for total indirect taxes and similar in magnitude to PIT. The following broad observations can be made with respect to the predictive quality of BE for Union government's tax revenues:

a. In general, tax revenues have been overestimated throughout the period under analysis.
b. RE remain overestimates but the margin of error is reduced significantly
c. CIT is predicted better as compared to PIT and total indirect taxes.
d. Across periods, period 1 shows largest percentage errors on average and periods 2 and 4 show much lower errors.

Chart 10.2: Union government's non-tax revenues: Percentage error relative to actuals

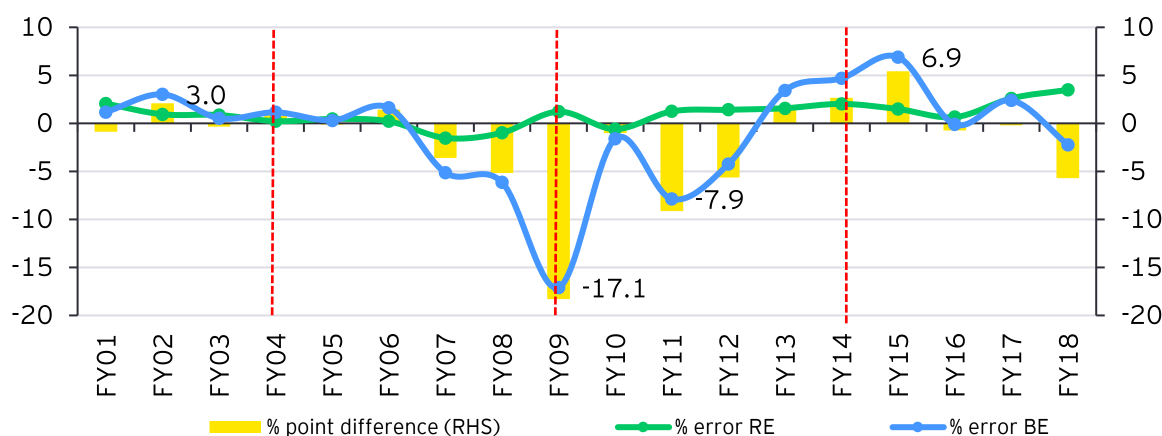


Source (basic data): Union Budget documents, various years

In the case of non-tax revenues, the nature of error reversed itself particularly in the earlier periods, where cases of underestimation were more pronounced with respect to both BE and RE. In periods 3 and 4, there are years of overestimation and underestimation. In period 4, the cases of overestimation became more prominent and the magnitude of errors also increased (Chart 10.2).

Expenditure aggregates

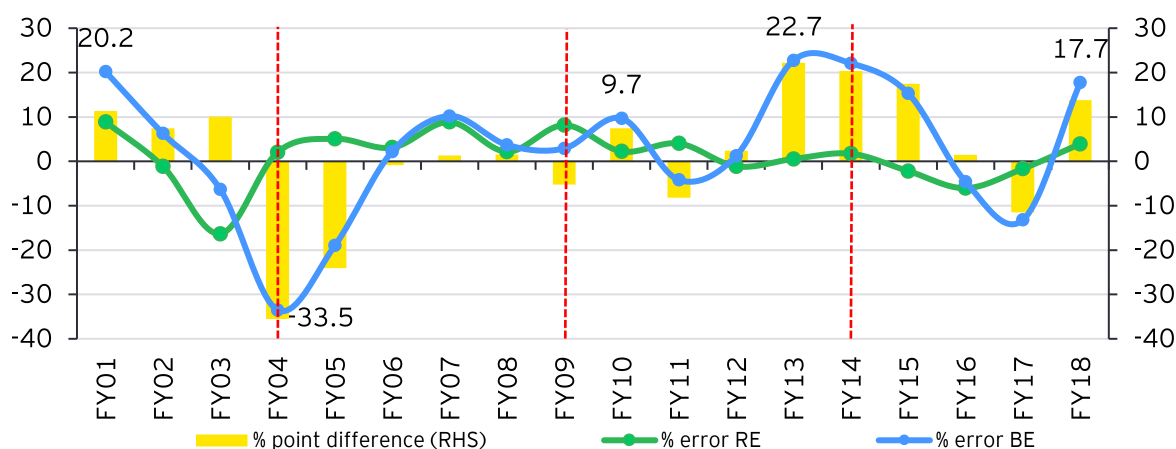
Chart 10.3: Union government's revenue expenditure: Percentage error relative to actuals



Source (basic data): Union Budget documents, various years

In the case of Union government's revenue expenditure, there was considerable underestimation around FY09, which was the year of global economic and financial crisis. In fact, prior to that, the BE and RE percentage error (% error) lines had remained close to the zero error line (Chart 10.3). There was overestimation of a small magnitude. However, underestimation of revenue expenditure started from FY07 and due to the need for stimulating the economy in the wake of the crisis, expenditures were deliberately uplifted as compared to the budgeted amounts in FY09. The trend of underestimation continued until FY12. In the case of the current government, in most years, there was overestimation of revenue expenditure. This may be largely because of the need for curtailing revenue expenditures in order to remain close to the fiscal deficit target. In this case also, we observe that RE show considerable improvement over BE in their predictive quality. The only noticeable departure in this pattern is in some of the recent years where even the RE were noticeably higher than the corresponding actuals.

Chart 10.4: Union government's capital expenditure: Percentage error relative to actuals



Source (basic data): Union Budget documents, various years

In the case of capital expenditures, the longer term pattern indicates a larger number of years covering periods 2 and 3 and the initial years of period 4, which are cases of overestimation. Actual expenditures have turned out to be lower (Chart 10.4). Again, this may possibly be because of the need to limit departures from fiscal deficit targets which generally lead to compromizing the capital expenditure . As a result, the BE and even the RE proved to be overestimates. The inter-period variations in % errors for capital expenditure and other expenditure components are summarized in Table 10.3.

Table 10.3: Union government's expenditures and major components: Average % errors in RE and BE

Period	Total exp.		Capital exp.		Rev. exp		Interest payments		Pensions	
	RE	BE	RE	BE	RE	BE	RE	BE	RE	BE
Period 1	0.5	-0.02	-1.6	-3.3	1.0	1.5	-0.9	1.4	-0.7	3.9
Period 2	0.7	-5.1	5.5	0.01	-0.1	-5.3	-1.1	-2.9	-0.1	-9.4
Period 3	1.2	0.2	1.5	10.3	1.1	-1.1	1.9	2.0	-9.9	-17.7
Period 4	1.6	1.9	-1.5	3.8	2.1	1.7	0.7	2.5	-3.8	-9.3

Source (basic data): Union budget documents, various years

In the case of interest payments, the average % error has ranged from -2.9% (period 2) to 2.5% (period 4). Since interest liabilities are known in advance, even this margin of error appears to be excessive. The higher magnitude of % error in the case of pensions tends to be underestimated. The margin of error at (-) 17.7% for BE and (-) 9.9% for RE are unduly large since pension expenditures are also easily estimable in advance.

We also looked in greater detail at some of the sub-categories of expenditures under the broad heads of social and economic revenue expenditures. In particular, we looked at education, health and agriculture and rural development. This analysis covered two of the latter periods for which comparable data was available.

Table 10.4: Major components of revenue and capital expenditure: Average % errors in RE and BE

Period	Revenue expenditure						Capital expenditure					
	Education		Health and water supply		Agr. and rural dev.		Defence exp.		Non-defence exp.		Loans and advances	
	RE	BE	RE	BE	RE	BE	RE	BE	RE	BE	RE	BE
Period 3	-5.3	-3.2	-7.5	1.2	-0.9	-4.7	-2.5	5.7	5.4	21.8	1.7	-13.2
Period 4	-2.7	-1.4	-6.5	-1.9	9.8	4.7	-2.6	7.4	-0.3	2.8	1.4	17.4

Source (basic data): Union budget documents, various years
Notes: (a) Education includes general education and technical education; (b) health and water supply includes medical and public health, family welfare and water supply and sanitation; (c) agr. and rural dev. includes agriculture and allied activities and rural development

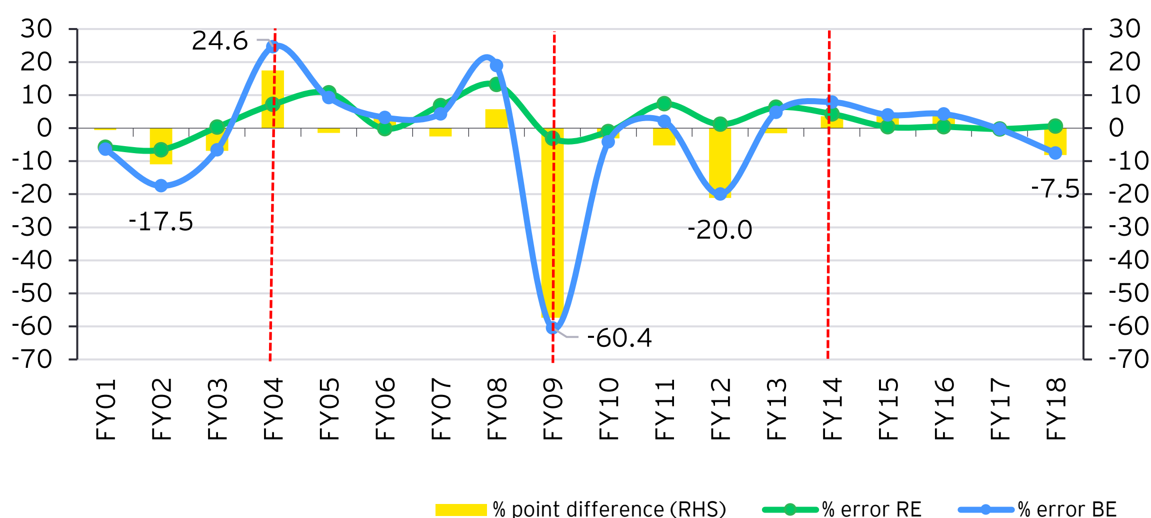
In the case of education and health, the actual expenditures on average tends to be higher than the BE as well as the RE. That is why, there is an underestimation reflected in the negative sign of the % error for BE and RE. In fact, the % error becomes higher in RE as compared to BE (Table 10.4). This phenomenon indicates concentration of spending in the last quarter of the fiscal year, which even the RE, have not been able to capture. It is quite possible that most of education and health expenditures relate to committed expenditures which may be in the form of salaries, pensions, etc. and even when as part of an expenditure compression plan following pressures on fiscal balance, these do not succeed in the case of education and health. In the case of agriculture and rural development, which is another critical area of government spending, there is a notable difference between periods 3 and 4. Period 3 shows underestimation while period 4 shows overestimation. In fact, in period 4, the RE show that the magnitude of error has nearly doubled. This is indicative of the fact that while the spending plans focussed on agriculture and rural development may have been announced and provided in the RE, the corresponding actual expenditures turned out to be significantly lower.

Capital expenditures are divided into loans and advances and capital outlay. Capital outlay is further divided into defence and non-defence categories. In the case of loans and advances, the magnitude of prediction error in the BE is one of the highest. For period 3, it was a case of underestimation with the average % error for BE at (-) 13.2%. For period 4, it was an overestimation of BE with the magnitude of % error being as high as 17.4%. This last episode indicates that maximum adjustment relative to BE might have happened in the case of loans and advances and this adjustment took place at the time of presenting the next year's budget where RE of the current year are presented. In the context of capital outlay, the BE are overestimates for both periods 3 and 4, indicating that budgeted expenditures could not be spent. But the direction of errors changed from over to underestimation while preparing the RE in both the periods. In the case of non-defence expenditure, the average % error for BE was nearly 22% in period 3. In period 4 also, it was a case of overestimation. It is clearly indicated that when pressures of adhering to fiscal deficit targets

arise, in relative terms, maximum downward adjustment is made in the case of non-defence capital expenditure and loans and advances.

Fiscal imbalances

Chart 10.5: Union government's fiscal deficit: Percentage error relative to actuals



Source (basic data): Union Budget documents, various years

In the case of fiscal deficit, the number of years of overestimation of BE are more than the number of years of underestimation. However, in the years of underestimation (e.g., FY09 and FY12), the magnitude of error is quite high (Chart 10.5). The rationale for underestimating BEs could be an attempt towards reducing fiscal deficit so as to come close to the FRBM target. But the actuals turn out to be higher than these ambitious targets. As a result, the BEs prove to be underestimated. However, by the time the fiscal year closes and the RE are prepared, the budgeted fiscal deficit targets are adjusted upwards. Over the longer period history, the maximum error in BE for predicting fiscal deficit was in FY09 at (-) 60.4%, immediately after the global economic and financial crisis. In fact, just one year prior to this, for the first and only time, the central government was able to achieve the FRBM fiscal deficit target of 3% of GDP. However, post the global crisis and in the wake of the 2009 election, there was a large unanticipated slippage from the budgeted fiscal deficit target. In FY12 also, a fiscal stimulus was attempted, although it was not anticipated in the budget. That is why the magnitude of % error was high at (-) 20% in this year.

Table 10.5: Major components of fiscal and revenue deficits: average percentage errors in RE and BE

Period	Fiscal deficit		Revenue deficit	
	RE	BE	RE	BE
Period 1	-1.2	-1.4	-4.7	-6.9
Period 2	5.5	-5.0	5.6	-7.2
Period 3	3.6	-1.9	3.1	-5.3
Period 4	0.3	0.1	-1.0	0.8

Source (basic data): Union Budget documents, various years

Revenue deficit reflects the extent to which borrowing is utilized for financing revenue expenditures. A high value of this is reflective of a poorer quality of utilization of fiscal deficit. Keeping revenue deficit low relative to fiscal deficit therefore is a desirable target (Table 10.5). For the first three periods, in preparing the BE, the revenue deficit was understated as the

corresponding actuals turned out to be higher, resulting in a negative sign for the % error. This pattern is reversed in period 4 where there is a marginal overestimation in the BE of revenue deficit. However, it is the RE which show a negative sign for this period.

Conclusion

Based on reviewing the accuracy of BE and RE as predictors of corresponding actuals, we noticed a clear improvement in union government's fiscal marksmanship over time. This improvement may be linked to the introduction of the fiscal responsibility targets among other revenues. Slippages in fiscal imbalances are tracked by analysts, domestic markets, international observers and general public, at large. The main findings may be summarized as below:

1. Central government's gross taxes have been overestimated throughout the period under review but the magnitude of % error has come down noticeably in period 2 and more recently in period 4.
2. In relative terms, budget and revised estimates for CIT are closer to actuals compared to PIT and indirect taxes.
3. In the case of non-tax revenues, % errors are relatively high in periods 3 and 4 and there have been shifts in the direction of errors. In periods 1 and 2, an underestimation is noticeable whereas in period 4 in most years, there was an overestimation.
4. In the case of revenue expenditures, the predictive quality of estimates deteriorated over time. It was maximum in the year of the global economic and financial crisis i.e., FY09. But afterwards also, particularly in the recent years, revenue expenditures were overestimated in the budgets.
5. In the case of capital expenditure, there are phases of overestimation as well as underestimation. Maximum revisions take place as we come closer to the end of fiscal years in non-defense capital expenditures in order to minimize variations from the fiscal deficit targets.
6. In the budget estimation of fiscal deficit, the number of years of overestimation of BE are more than the number of years of underestimation. However, in the years of underestimation (e.g., FY09 and FY12), the magnitude of error is quite high. In all cases, RE show a significant improvement in the predictive quality of estimation.

The quality of the union government's fiscal marksmanship appears to have improved. This may be partly the consequence of the need to adhere to the FRBMA targets.

Chapter 11

Budget 2019-20: Towards a US$5 trillion Indian economy - Budget and beyond (July 2019)

Abstract

The FY20 budget called for reaching a US$5 trillion target in the next few years. In the background of an ambitious 'National Infrastructure Pipeline', this budget estimated the requirement of infrastructure investment averaging INR20 lakh crore per year. This amounted to about 9.5% of GDP in FY20, which was the required additional investment in that year. To uplift the investment rate, a significant increase in the domestic saving rate was required. To some extent, external resources could augment the volume of resources, but this was constrained by sustainability considerations. Any borrowing from abroad would carry a significant exchange rate risk. In any case, whether the government borrows from domestic or external sources, it is subject to the overall fiscal deficit of 3% of GDP. In order to fill the gap, the state governments and the private sector will have to participate in the investment expansion program in a big way. The central government can increase its investment by reducing revenue deficit and utilizing its non-debt capital receipts. It can also scale up substantially, the participation of Central Public Sector Enterprises in government's infrastructure expansion program. Only if the expansion by the central government is large enough, there would be the possibility of crowding in private sector investment.

Linking size to required growth

The Union Budget for FY20 indicates the size of the Indian economy at US$5 trillion in the "next few years". Prior to this, the Economic Survey had specified that this target would be achieved by FY25 (end-March 2025). In FY19, the size of the Indian economy was US$2.7 trillion. Its growth for the next six years covering FY20 to FY25 can be considered in terms of three components: (1) real GDP growth, (2) inflation rate and (3) exchange rate depreciation. Assuming an inflation rate of 4% which is the target inflation rate as per the Monetary Policy Framework, a real growth rate close to 9% would be required to increase the size of the Indian economy to US$5 trillion by FY25. This implies a nominal growth rate of 13%, assuming an average annual depreciation of the INR viz.-a-vis. the US$ at 2%. The annual paths of the trajectories of these three variables are detailed in Table 11.1.

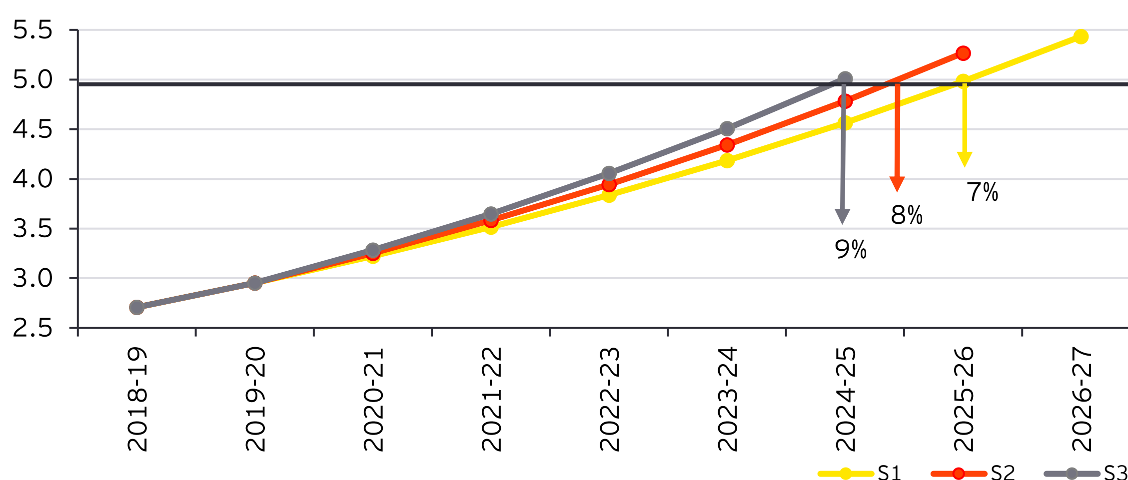
Table 11.1: Growth required to achieve a US$5 trillion economy by FY25

Year	Nominal GDP (INR trillion)	Real growth rate (%)	Derived nominal growth* (%)	Exchange rate (INR/US$)	Nominal GDP (US$ trillion)
FY19	190.1	6.8	11.1	70.2	2.7
FY20	211.5	7.0	11.3	71.6	3.0
FY21	239.8	9.0	13.4	73.0	3.3
FY22	271.8	9.0	13.4	74.5	3.6
FY23	308.2	9.0	13.4	76.0	4.1
FY24	349.3	9.0	13.4	77.5	4.5
FY25	396.0	9.0	13.4	79.1	5.0

Source (basic data): IMF, Union Budget FY20
Note: nominal growth rate is calculated as real growth rate plus inflation rate plus interaction term.
*on the assumption of an inflation rate of 4% per annum

However, in FY20, the projected real growth rate as per the Economic Survey is only 7%. With an inflation rate of 4%, a nominal growth rate of 11% appears feasible. The Budget FY20 also assumes a nominal growth rate of 11% when this is calculated with respect to the provisional estimate of GDP for FY19.

Chart 11.1: Growth simulations for the Indian economy (size in US$ trillion)



Source (basic data): Union Budget FY20, CSO (MOSPI)
Note: S1, S2 and S3 pertain to simulations assuming annual real growth rates of 7%, 8% and 9% respectively beginning 2019-20 for S1 and 2020-21 for S2 and S3

Missing the nominal growth target of 13% in the first year itself of the six-year period covering FY20 to FY25 implies that the target nominal and real growth rates for the remaining five years should be increased to above 13% and 9% respectively. We examine the prospects of uplifting the real growth from its current level of 6.8% to such levels, considering investment as its main determinant.

Simulations can be done with alternative growth assumptions to see the trajectory indicating the year by which the US$5 trillion target would be achieved. We have considered real growth rates at annual averages of 7%, 8% and 9%. The following parameters are common in all three simulations: real growth rate of 7% in FY20, inflation and exchange rate depreciation in all years at 4% and 2% respectively. In the subsequent years starting FY21, for simulations 1 (S1), 2 (S2) and 3(S3), real growth rates are kept at 7%, 8% and 9% respectively. It is shown in Chart 11.1 that the US$5 trillion target is reached by FY25 at the real growth rate of 9%. It is shifted to FY26 with 8% growth and further to FY27 with 7% growth. If the inflation rate is lower than 4% on an average and if the exchange rate depreciation is higher than 2% per annum, reaching the size of US$5 trillion would be delayed even beyond these target years of FY25, FY26 and FY27.

We now consider the possibility of raising the growth rate to 9% in FY21 which would require uplifting the investment rate to close to 38% of GDP, that is an increase of about 6.5 percentage points of GDP. The extent to which the policymakers succeed in uplifting the investment rate from its level at 31.3% in FY19 would determine the year by which the benchmark size of US$5 trillion would be crossed.

Role of central government in determining overall investment rate

In FY19, the gross investment rate, estimated at 31.3%, was able to deliver a real growth rate of 6.8%. The implicit incremental capital-output ratio (ICOR) was 4.6. This is relatively high because of deficient capacity utilization. According to the RBI, the extent of capacity utilization was at 75.9%[15] in Q3FY19. Historically, India's average ICOR during the three-year period from FY17 to FY19 has averaged 4.2[16]. The highest achieved investment rate in India was 39.6% in FY12. Achieving such levels would be consistent with the requirements of our demographic dividend. In China, average saving and investment rates of close to 45% have been maintained for a long period.

Total investment is the sum of public investment, household investment and investment by the private corporate sector. Information about their relative contribution to the overall investment rate is available only up to FY18. This information is summarized in Table 11.2.

Table 11.2: Components of gross investment

Year	Gross investment	Public sector	*Households**	*Pvt. corp. sector**	Total investment* excluding valuables and errors and omissions	Valuables
As % of GDP						
FY17	30.2	7.0	10.7	11.4	29.1	1.1
FY18	30.9	7.4	10.6	11.6	29.7	1.3
FY19	31.3	7.0	NA	NA	29.1	1.0
As % of gross investment						
FY17	100.0	23.3	35.5	37.6	96.4	3.6

[15] 'OBISCUS Survey on the Manufacturing sector – Q3: 2018-19', RBI; https://rbi.org.in/Scripts/PublicationsView.aspx?id=18946
[16] Estimated with reference to nominal investment rate as % of GDP

Year	Gross investment	Public sector	*Households**	*Pvt. corp. sector**	Total investment* excluding valuables and errors and omissions	Valuables
FY18	100.0	24.0	34.3	37.6	95.9	4.1
FY19	100.0	22.5	NA	NA	96.7	3.3

Source (basic data): MoSPI, Union Budget Documents, CAG, CGA
*includes change in stocks

The central government plays a four-fold role in determining the overall investment rate. First, it directly invests through its budgetary capital expenditure. Second, it can invest through its CPSEs. Third, it may, through its policy initiatives, induce the private sector to increase their investment. Fourth, Union government can coordinate with the state governments particularly the large ones to increase their budgetary capital expenditures as well as expenditure undertaken through state-level public-sector enterprises (SPSEs).

As indicated in Table 11.3, the Union government's share in India's aggregate investment was quite small at 1.6% of GDP in FY19 as per actuals from CGA, constituting only 5.1% of the aggregate investment. Adding to this, CPSEs' capital expenditure of 2.4% of GDP in FY19, the Union government's contribution to the investment increases to 4.0% of GDP, which is 12.6% of the total investment. This can be substantially improved. The Union government may therefore provide a policy framework to induce the state governments and the private sector to uplift their investment rates. Furthermore, if the central government can successfully reduce its revenue deficit, there would be room for higher capital expenditure with the same fiscal deficit. It can also induce additional investment through the CPSEs while keeping in mind, the overall constraint of resources in the form of savings in the system.

Potentially, both central and state governments under their respective FRBMs can incur fiscal deficits up to 3% of GDP each. If they were to follow the golden rule of using the entire fiscal deficit for capital expenditures by keeping the revenue account in balance, their capital expenditures can be in excess of 3% of GDP each by adding non-debt capital receipts which include the disinvestment receipts. At least accounting for 3% of GDP each as potential capital expenditure by the central and state governments while adhering to their respective FRBMs, the general government's contribution to the investment rate would be 6% of GDP. The CPSEs and SPSEs are not subject to FRBM limits. Another 6% of GDP can come from CPSES and SPSEs. Thus, the total contribution of the public sector can potentially increase to 12% of GDP, which is more than double their current contribution.

Table 11.3: Components of public sector investment

Year	Gross Investment rate	Central government	CPSEs	Total	State governments (derived)	SPSEs (derived)	Total	Public sector total
	1	2	3	4=2+3	5	6	7=5+6	8=4+7
As % of GDP								
FY17	30.2	1.9	2.2	4.1	2.0	1.0	3.0	7.0
FY18	30.9	1.5	2.3	3.9	2.5	1.0	3.5	7.4
FY19	31.3	1.6	2.4	4.0	2.1	1.0	3.1	7.0
FY20	NA	1.6	2.1	3.7	NA	NA	3.1*	6.8*
As % of gross investment								
FY17	100.0	6.1	7.3	13.4	6.5	3.4	9.9	23.3
FY18	100.0	5.0	7.6	12.5	8.2	3.3	11.4	24.0
FY19	100.0	5.1	7.5	12.6	6.6	3.3	9.9	22.5

Source (basic data): MoSPI, Union Budget Documents, CAG, CGA;

Notes: Investment undertaken by a) general government and b) public sector enterprises (PSE) is available till FY18 from National Accounts. Central government's investment is taken as its capital expenditure sourced from Union Budgets and CGA. State government's investment is derived by reducing central government investment from general government investment for the years FY17 and FY18. For FY19, state government investment is estimated using data from CAG and RBI. Data on investment by CPSEs is taken from Statement 25 of the Union Budget of the respective years. Investment by SPSEs is derived residually by reducing the investment by CPSEs from the total investment by public sector enterprises for FY17 and FY18. For FY19 and FY20 investment by SPSEs is assumed to be 1.0% of GDP, that is, the average for FY17 and FY18.
CPSE-Central Public-Sector enterprises; SPSE-State Public Sector Enterprises
*assuming state level contribution continues at the level of FY19

Financing of investment

Potential investment through all the channels namely central and state governments, the central and state public-sector enterprises and the private sector is constrained by the supply of investible resources. Total investible resources in India consist of domestic savings and net foreign capital inflows. Domestic savings as percentage of GDP have fallen from their previous peak of 34.6% in FY12 to about 30% in FY19, that is a fall of 4.6 percentage points (Table 11.4). The main reason for this fall is the household sector where aggregate savings relative to GDP have fallen by a margin of 6.5 percentage points from FY12 to FY18. To some extent, this fall was made up by an increase in the savings of private corporate sector by a margin of 2.2 percentage points of GDP. The public sector's savings increased by a low margin of 0.2 percentage points of GDP during this period.

Table 11.4: Components of gross domestic savings (% of GDP)

Year	Gross domestic savings	HH sector total	HH sector financial savings	HH sector physical savings	Private corporate sector	Public sector
FY08	36.8	22.4	11.6	10.8	9.4	5.0
FY09	32.0	23.6	10.1	13.5	7.4	1.0
FY10	33.7	25.2	12.0	13.2	8.4	0.2
FY11	33.7	23.1	9.9	13.2	8.0	2.6
FY12	34.6	23.6	7.4	16.3	9.5	1.5

Year	Gross domestic savings	HH sector total	HH sector financial savings	HH sector physical savings	Private corporate sector	Public sector
FY13	**33.9**	22.5	7.4	15.1	10.0	1.4
FY14	**32.1**	20.3	7.4	12.9	10.7	1.0
FY15	**32.2**	19.6	7.1	12.5	11.7	1.0
FY16	**31.1**	18.0	8.1	9.9	11.9	1.2
FY17	**30.3**	17.1	6.3	10.8	11.5	1.7
FY18	**30.5**	17.2	6.6	10.6	11.6	1.7

Source (basic data): MOSPI

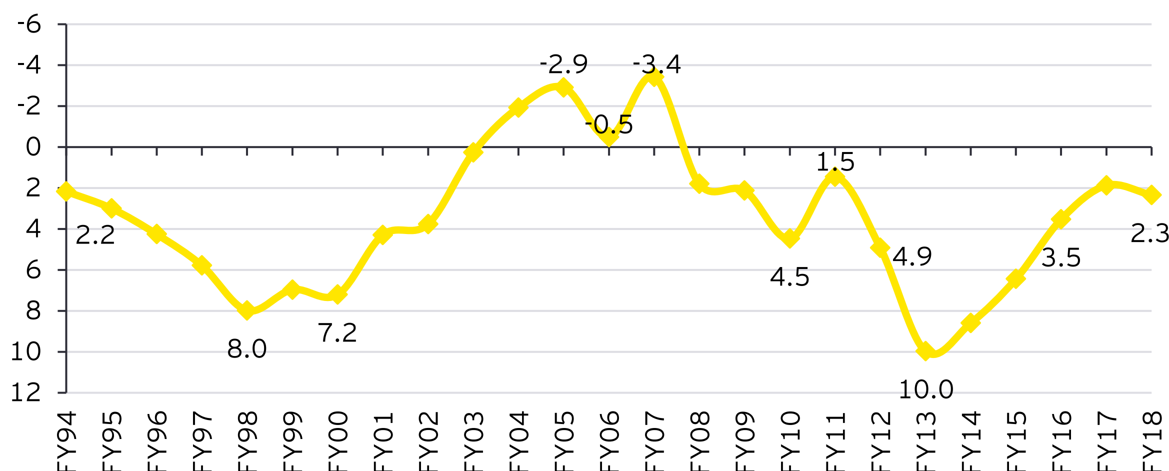
Feasible levels of net capital inflow which depend on sustainable levels of current account deficit can be considered in the range of 2-2.5% of GDP. Any sovereign borrowing from the external market would have to be considered within these overall limits. Stretching net foreign capital inflow much above 2.5% of GDP may involve considerable foreign exchange risk. It is thus clear that the aggregate domestic saving rate needs to be increased in excess of 6 percentage points of GDP to finance the additional investment required to achieve a real growth of 9%.

Revenue deficits of the central and state governments are indicative of their dissaving. Available information indicates that state governments have been maintaining balance on revenue account or showing small surplus in recent years. As such, their dissaving is zero. It is the central government which can, by undertaking further expenditure reforms, reduce its revenue deficit to zero so that its dissavings are also driven to zero. Public sector saving would increase by the margin by which the central government would reduce its revenue deficit. Potentially, this can add more than 2 percentage points of GDP to public sector savings. The balance of 4 percentage points will have to come from the household sector. In their case, both physical and financial savings have fallen from their respective peaks. For this purpose, they need to be incentivized through tax concessions. The emphasis on affordable housing may induce them to increase their physical savings and investment. For improving their financial savings, additional incentives need to be considered including a tangible premium on the average interest rate on small saving instruments.

Foreign currency sovereign bonds and other growth initiatives

The Union Budget has proposed a number of growth-promoting initiatives to induce the private sector for a more active participation in uplifting their investment rate. The government proposes to access global investors by floating sovereign bonds denominated in external currency. Global interest rates are much lower than that in India, and exchange rate depreciation is estimated at 2% per annum by the IMF. The central government can borrow abroad at about 3-4% per annum considered in equivalent rupee terms as compared to about 7% in the domestic market. The amount, however, would need to be kept small since there is an associated exchange rate risk. The history of exchange rate movement shows considerable volatility as depicted by Chart 11.2. In the recent past, the average depreciation rate was as high as 10% per annum during 2012 to 2014. This was also a period of high inflation rate. As the inflation rate was brought down in the subsequent years, the depreciation rate has also come down. If India maintains an average inflation rate of 4%, which is about 2 percentage points higher than that in some of the developed countries with whom India has relatively large volume of trade, it may be possible to maintain an exchange rate depreciation of 2% per annum on average over a longer period. However, exchange rate movements do depend on various other factors including magnitudes of exports and imports of goods and services, capital inflows and outflows through different channels and level of foreign exchange reserves. India's exchange rate is particularly sensitive to global crude price movements.

Chart 11.2: Exchange rate movement (INR/US$): Three-year moving average



Source (basic data): RBI

Note: -ve sign indicates appreciation and +ve sign indicates depreciation

To the extent investment in India is financed by external savings in this manner, the pressure on domestic savings and interest rates will ease. This may give a boost to private investment in India. It might also facilitate financing government's ambitious infrastructure expansion plans through the PPP route and otherwise. Investment activities would also get a fillip through initiatives such as attracting global investors for setting up mega-manufacturing plants to bring in advanced technology in electric vehicles, electronics and other related areas. The sharper focus of Make in India to select sectors such as MSMEs, start-ups, defence manufacturing, automobiles and electronics may also yield positive outcomes. Further relaxation of the FDI norms introduced in this budget would augment FDI inflows into the economy. The speed with which India can achieve a growth of over 8% may depend largely on the pace and extent of success in implementing these initiatives.

Anticipated release of excess reserves from RBI

Another source of funds can come from the release of special dividends from the RBI aimed at transferring a part of its reserves that are assessed to be excess reserves. The Bimal Jalan committee (the committee) has come up with its recommendations. The total reserves with the RBI as per their 2017-18 annual report amounted close to INR10 lakh crore, that is close to 5% of GDP. Although the magnitude to be transferred as surplus reserves to the Government of India is not clear, the committee has recommended that this transfer be made in a phased manner over a period of three to five years. Considering, as an example, that about one-third of the existing reserves may be transferred as excess reserves over a period of three years, nearly 0.6% of GDP may be transferred in each of these years adding to a total of 1.8% of GDP. If transferred as special dividends, this would add to government's non-tax revenues and may be used to reduce government's revenue deficit and add to its capital expenditure by an equivalent margin assuming that fiscal deficit is kept at the present target of 3.3% of GDP.

Concluding observations

The Budget indicates the requirement of infrastructure investment averaging INR20 lakh crore per year[17]. This amounts to 9.5% of GDP in FY20 which is the required additional investment in the current year. To uplift the current investment rate, significant increase in the domestic saving rate is required. To some extent, external resources can augment the volume of resources, but this is constrained by sustainability considerations. Any borrowing from abroad would carry a significant

[17] Union Budget FY20 Budget Speech, paragraph 30.

exchange rate risk. In any case, whether the government borrows from domestic or external sources, it is subject to the overall fiscal deficit of 3% of GDP. In order to fill the gap, the state governments and the private sector will have to participate in the investment expansion program in a big way. The central government can increase its investment by reducing revenue deficit and utilizing its non-debt capital receipts. It can also scale up substantially, the participation of CPSEs in government's infrastructure expansion program. Only if the expansion by the central government is large enough, there would be the possibility of crowding in private sector investment.

Chapter 12

Budget 2020-21: Combating the economic slowdown under conditions of revenue uncertainty

(February 2020)

Abstract

The FY21 Union Budget was presented in the backdrop of a significant downslide in economic growth in both real and nominal terms which had translated into a sharp erosion in tax revenue growth. This erosion in revenue growth was partly the result of the initial impact of the comprehensive CIT reforms undertaken in FY20. In this analysis, we had examined in detail the potential of the 'National Infrastructure Pipeline'. The real success of the NIP would, therefore, depend not on center's budgetary support to infrastructure, but the contributions made by CPSEs, state governments, SPSEs and the private sector. The success of such planned investment depended on the nature of the concerned projects and the ability of the central government to bring together these different entities on a common platform. We also note that the finances of the state governments would be under pressure because of the impact of the economic slowdown and the likelihood of lower magnitude of central transfers due to anticipated shortfall in central gross tax revenues. This may adversely impact the expected contribution of the state governments to the NIP endeavor. While the FY21 budget estimates were prepared, there was no anticipation of the debilitating impact of COVID-19 which was around the corner.

Introduction

The FY21 Union Budget was presented in the backdrop of a significant downslide in economic growth in both real and nominal terms which had translated into a sharp erosion in tax revenue growth. For policymakers, these conditions are significantly challenging since neither monetary policy instruments nor fiscal policy instruments appear to have any tangible sharp edge. In case of monetary policy, the five successive repo rate cuts since February 2019 have failed to deliver due to inadequate transmission so far. With CPI inflation continuing to show upward pressure, any further reduction in the repo rate does not seem viable. On the fiscal side, it is difficult to provide any meaningful stimulus under conditions of a significant erosion in tax revenue growth.

The FY21 budget is characterized by significant revenue uncertainties particularly on account of tax revenues. The reliability of the revised estimates (RE) for FY20 will only be clear when these are tested against the corresponding actuals in about three months' time when the actual data for FY20 is released by the CGA. The FY21 budget proposals need to be assessed in terms of, among other considerations, the following issues:

1. Whether the FY20 RE of tax revenues are likely to be realized since these constitute the base year numbers for FY21 budget estimates?
2. What is the true extent and quality of fiscal deficit in FY20 RE and FY21BE?
3. What is the credible quantum of fiscal stimulus inherent in the budget proposals for FY20 and FY21?
4. To what extent the proposed National Infrastructure Pipeline (NIP) is dependent on union government's budgetary support?

Assessing FY20 RE of tax revenues: Uphill task

As per CGA data covering the first three quarters of FY20, there is a contraction in union government's gross tax revenues of (-) 2.9%. The budget was candid enough to keep the annual growth in union government's gross tax revenues in FY20 RE at 4%. However, even to realize this low growth target, a growth rate of 19% is required in the last quarter of FY20.

A comparison with actual growth rates in the last quarter of some of the previous years as given in Table 12.1 indicates that this would be an uphill task. In the case of PIT, a growth of 51.6% is required in the last quarter of FY20 for realizing the RE for FY20. In the case of IDT, the required growth is 18% as against an actual growth performance of only 0.1% in the first three quarters. One unknown in this context relates to the extent of success of the 'Vivad se Viswas' scheme.

Table 12.1: Cumulated growth required during 4QFY20 to achieve FY20 (RE)

Year	Gross tax revenues	DT	CIT	PIT	IDT
Cumulated growth (%) during April-December of each fiscal year					
FY15	7.0	7.3	6.6	8.4	6.3
FY16	21.1	10.7	10.1	11.7	34.8
FY17	18.3	10.7	4.8	20.5	25.0
FY18	17.3	17.1	17.1	17.0	17.3
FY19	6.6	14.5	14.0	15.2	1.0
FY20	**-2.9**	**-5.8**	**-13.6**	**5.1**	**0.1**
Cumulated growth (%) during January-March of each fiscal year					

Year	Gross tax revenues	DT	CIT	PIT	IDT
FY15	13.7	11.3	12.7	9.2	16.5
FY16	9.9	0.0	-1.6	2.6	22.1
FY17	17.1	15.6	10.6	23.5	15.1
FY18	0.8	21.7	19.1	25.4	-17.1
FY19	12.6	15.7	20.4	9.3	8.5
FY20 (required)	**19.0**	**22.1**	**2.1**	**51.6**	**18.0**

Source (basic data): Union Budget FY21, CGA

Measuring genuine fiscal deficit

In this section, we consider the true fiscal deficit in FY20 and FY21 based on the official data. In both the years, according to the budget estimates, fiscal deficit has slipped by 0.5 percentage points of GDP from the previously announced targets at 3.3% for FY20 and 3% for FY21 under the Fiscal Responsibility and Budget Management (FRBM) Act. In both years, the slippage takes the fiscal deficit to 3.8% and 3.5% of GDP, respectively. The actual magnitude of the slippage in FY20 may however depend on the extent to which non-tax revenues are augmented by the AGR payments by the telecom companies. Nonetheless, the true fiscal deficit is significantly larger if we take into account the off-budget borrowing and the borrowing from National Small Saving Fund (NSSF). The relevant numbers are given in the appendix to the finance minister's budget speech for FY21.

Off-budget borrowings relate to borrowings done by various special purpose vehicles (SPVs) of public sector enterprises (PSEs) attached to different ministries where the entire burden of servicing the additional liability is on the central government, that is, on budgetary resources. Borrowing from NSSF is also on the same footing.

In recent years, the union government has been using the Food Corporation of India (FCI) to borrow from the NSSF in lieu of the due payment of food subsidy. Had this food subsidy been directly paid by the central government, it would have been part of government expenditure and the corresponding amount would have been directly funded by fiscal deficit if government's tax and non-tax resources fell short. The FCI's borrowing from the NSSF amounts to substitution of financing of government's subsidy expenditure such that the amount is not included in the fiscal deficit. In fact, not only the entire burden of servicing this additional borrowing is to be borne by budgetary resources but such borrowing is shown as part of government's liability. If we add these two elements, the true fiscal deficit amounts to INR9,21,430 crore (4.5% of GDP) in FY20 (RE) and INR9,82,437 crore (4.4% of GDP) in FY21 (BE). Another way of cross checking these numbers is by looking at the change in government's liabilities in these two years. This is shown in Table 12.2.

Table 12.2: Quantum of true fiscal deficit

Year	Change in liabilities	Fiscal deficit	EBR not included in outstanding liabilities statement	Financial support extended to FCI through loans from NSSF	True fiscal deficit
	1	2	3	4	5=2+3+4
In INR Cr					
2018-19	8,48,038	6,49,418	89,864	97,000	8,36,282
2019-20 (RE)	9,34,905	7,66,846	44,584	1,10,000	9,21,430
2020-21 (BE)	9,31,899	7,96,337	49,500	1,36,600	9,82,437
As % of GDP					
2018-19	4.5	3.4	0.5	0.5	4.4
2019-20 (RE)	4.6	3.8	0.2	0.5	4.5
2020-21 (BE)	4.1	3.5	0.2	0.6	4.4

Source (basic data): Union Budget FY21

If we consider change in outstanding liabilities as an indicator of fiscal deficit, fiscal deficit in FY20 (RE) and FY21 (BE) amounts to INR9,34,905 crore (4.6% of GDP) and INR9,31,899 crore (4.1% of GDP), respectively. However, the change in liabilities may not fully reflect the entire fiscal deficit in the current year to the extent that some of the off-budget borrowing is not added as liability of the government but remains only as a liability of the SPV through which such borrowing is done. Thus, the true fiscal deficit is nearly 1% point higher than what is shown explicitly as fiscal deficit in the budget. Part 2 (a) of the FRBM Act, 2003 defines fiscal deficit as the excess of total disbursements from the consolidated fund of India, excluding repayment of debt over total receipts into the Fund (excluding the debt receipts) during a financial year. The true extent of borrowing by the government is understated by keeping such borrowing outside the Consolidated Fund of India even though the servicing of such additional debt falls entirely on budgetary resources.

Furthermore, the slippage in fiscal deficit has not been fully used for augmenting capital expenditure, which would have created assets corresponding to the additional liabilities and provided a more direct and immediate stimulus. We examine the stimulus contained in the budget in the next section.

Estimating quality and extent of budgetary fiscal stimulus

We can examine the extent of fiscal stimulus by looking at the explicit increase in purchasing power in the hands of households as a result of budgetary initiatives. First, the estimated revenue cost of the concessionality announced in the case of personal income tax (PIT) amounts to INR40,000 crore. This pertains to lowering of the PIT rate and widening of the tax brackets which is given as an option to the tax assessees, provided they choose to forgo all existing deductions and exemptions. Since this is voluntary and depends on the option exercised by individual tax assessees, the full revenue impact will depend on the actual choices made. An additional INR25,000 crore is the estimated revenue cost of the abolition of the dividend distribution tax (DDT). This may be fully accessed by the companies and it will add to the additional profits which were left in the hands of the corporates as a result of the CIT rate reduction that was introduced in September 2019. The additional profits in terms of revenue forgone on CIT reform and the abolition of DDT does not fully translate into additional demand in the system because the companies may use the consequent additional profits in a variety of ways. These were discussed in detail in the October 2019 issue of the Economy Watch. In particular, companies are not likely to increase their investment demand

unless capacity utilization improves significantly. Until then, the additional corporate savings may be used for price reduction, reduction in corporate debt, additional dividend distribution and financing buybacks. Therefore, the stimulus out of these two budget initiatives in the case of direct tax may amount to INR65,000 crore at the maximum. In reality, it may only be a fraction of this.

Stimulus has also been provided in the form of additional direct purchases by the government financed from tax and non-tax revenues as well as additional borrowings. For this purpose, it is important to measure the extent of additionality relative to GDP. Since interest payments are only transfer payments, direct purchases by the government may be reflected in the change in the primary revenue expenditure relative to GDP between two consecutive years and the change in capital expenditure relative to GDP for these years. For this purpose, we have compared FY20 (RE) against FY19 (Actuals) and FY21 (BE) against FY20 (RE). These proportions relative to GDP and the corresponding magnitudes are given in Table 12.3.

Table 12.3: Additionality in expenditures: FY20 (RE) and FY21 (BE)

Item	In INR crore		In percentage points of GDP	
	FY20	FY21	FY20	FY21
Capital expenditure *of which*	**17,333**	**28,237**	**0.08**	**0.13**
Defence capital expenditure	7,780	-7,716	0.04	-0.03
Non-defence capital expenditure	9,554	35,952	0.05	0.16
Primary revenue expenditure	1,89,316	24,698	0.93	0.11

Source (basic data): Union Budget FY21

In the case of primary revenue expenditure, the incremental expenditure relative to GDP in FY20 (RE) over FY19 (Actual) is 0.93 percentage points. It is only 0.11 percentage points in FY21 (BE) over FY20 (RE). We have divided capital expenditure into two parts, namely, defence capital expenditure and non-defence capital expenditure. This is done due to their differential multiplier effects. With respect to total capital expenditure, the incremental expenditure relative to GDP in FY20 (RE) and FY21 (BE) amounts only to 0.1% point each as total government capital expenditure increased from 1.6% of GDP in FY19 to 1.7% in FY20 (RE) and to 1.8% in FY21 (BE). This also implies that while the slippage in fiscal deficit is that of 0.5 percentage points in both these years, the incremental capital expenditure amounts only to 0.1 percentage points each that is only one-fifth of the additional borrowing. In other words, approximately 80% of the additional borrowing in both these years is expected to be used for revenue expenditure or non-asset forming expenditure. Had these additionalities been fully used for capital expenditure, the financing of the National Infrastructure Pipeline (NIP) would have been on a more solid ground. We have discussed this in the next section.

In this context, we note that the multipliers associated with revenue and capital expenditure are different. Most studies indicate that the multiplier for the latter is much higher (Table 12.4).

Table 12.4: Estimates of expenditure multipliers in India: Selected studies

Policy variables	RBI (2013 study)@[18]	RBI (2019 study)@[19]	Expenditure multiplier estimates by Bose and Bhanumurthy[20] (2013)	Expenditure multiplier estimates by Goyal and Sharma[21] (2015)
Aggregate expenditure	0.40 (impact and peak)			
Revenue expenditure	0.19 (impact) 0.09 (peak)	0.45		1.69
Capital expenditure	0.39 (impact) 0.85 (peak)	3.25	2.45	2.38
Non-defence capital expenditure	2.10 (impact) 3.84 (peak)			
Transfer payments			0.98	
Other revenue expenditure*			0.99	

Source (basic data): Respective studies/reports
* Other revenue expenditure of the government is the revenue expenditure after netting out the transfer payments
@multiplier estimated for the central government
Note: RBI (2019 study) reports peak multipliers

Financing of NIP: Limited role of union government's budgetary investment

The core of government's revival strategy consists of the proposed NIP. In this case, over a six-year period from FY20 to FY25, an additional investment of INR102 lakh crore has been planned. This is to be financed by five different categories of investors, namely, central government, central public sector enterprises (CPSEs), state governments, state public sector enterprises (SPSEs) and the private sector. It is the central government's infrastructure expenditure which is supposed to serve as a pivot to attract state and private sector infrastructure expenditure and that of the CPSEs and SPSEs. These investments may include investments through the public private partnership (PPP) programs which have been planned earlier also. But actual success in this PPP financing mode of infrastructure projects has been quite limited. However, the NIP financing scheme gives a weight of 39:39:22 for union government including CPSEs, state including SPSEs and the private sector although the year-wise financing shares differ.

It can be seen that in terms of sectoral shares in infrastructure investment, the NIP is focused on five main sectors namely: (1) roads (19.2%), (2) AMRUT, smart cities, etc. (15.9%), (3) railways (13.4%), (4) power (11.5%) and (5) renewable energy (9.1%). Together, these five sectors account for close to 70% of the total infrastructure investment through NIP. This is shown in Chart 12.1.

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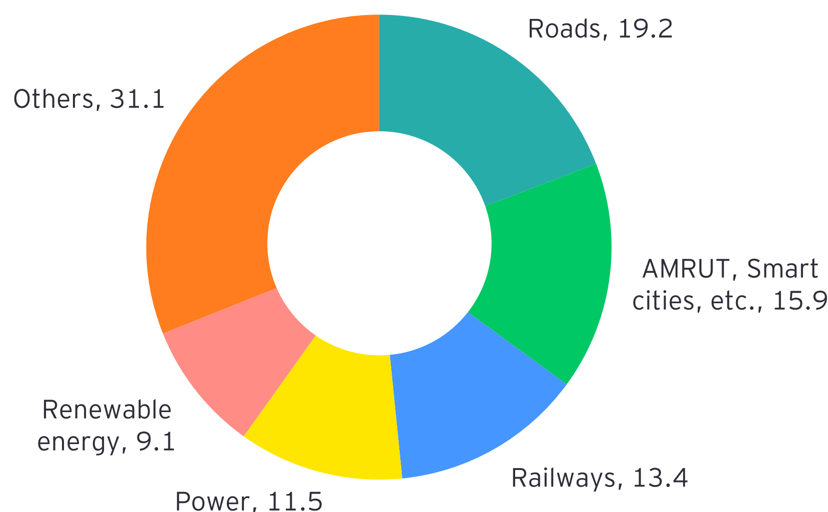
[18] https://www.rbi.org.in/scripts/PublicationsView.aspx?id=15369
[19] https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=18941
[20] Bose.S and N R Bhanumurthy, 2013. "Fiscal Multipliers for India", NIPFP Working Paper No.125.
[21] Goyal A, Sharma B (2015) Government expenditure in India: composition, cyclicality and multipliers. IGIDR Working Paper No. 32. IGIDR, Mumbai

Chart 12.1: Sectoral share (%) in total investment (NIP)



Source (Basic Data): National Infrastructure Pipeline, Government of India; http://164.100.117.97/WriteReadData/userfiles/DEA%20IPF%20NIP%20Report%20Vol%201.pdf

It is important to indicate the additionality in capital expenditure in the central and state budgets as a result of the NIP. The planned budgetary expenditure of the union government in the NIP is 0.9% of GDP on average per year (Table 12.5). Historically, union government has been allocating 1.1% of GDP on an average on non-defence capital expenditure which largely goes into infrastructure expansion. In other words, there is actually no additionality in central government's infrastructure expenditure through the NIP over its existing infrastructure expenditure.

Table 12.5: National Infrastructure Pipeline: Financing and targets (% of nominal GDP)

#	Entity	FY20	FY21	FY22	FY23	FY24	FY25
1	Total investment (TI)	6.6	8.6	7.5	4.8	4.0	3.0
2	Union government *of which:*	1.8	2.0	2.2	2.4	2.5	2.7
3	Budgetary support	0.7	0.8	0.9	1.0	1.0	1.1
4	CPSEs (2 - 3)	1.1	1.2	1.3	1.4	1.5	1.6
5	States (derived)	3.1	4.2	3.4	1.6	0.9	0.2
6	Private sector (derived)	1.7	2.4	1.9	0.9	0.5	0.1
Memo							
Nominal GDP growth (%)		**8.0**	**10.5**	**12.0**	**12.6**	**12.9**	**13.1**

Source (Basic Data): National Infrastructure Pipeline, Government of India; http://164.100.117.97/WriteReadData/userfiles/DEA%20IPF%20NIP%20Report%20Vol%201.pdf

The real success of the NIP would, therefore, depend not on union government's budgetary support to infrastructure, but the contributions made by CPSEs, state governments, SPSEs and the private sector. Whether such planned investment will really take off depends on the nature of the concerned projects and the ability of the central government to bring together these different entities on a common platform. We also note that the finances of the state government would be under pressure because of the impact of the economic slowdown and the likelihood of lower magnitude of central transfers due to anticipated shortfall in central gross tax revenues. This may adversely impact the expected contribution of the state governments to the NIP endeavor.

Chapter 13

Budget 2021-22: Key steps towards an economic revival plan (February 2021)

Abstract

Union Budget FY22, the first post-COVID budget, prepared the ground for the recovery of growth and economic activities. It implicitly assumed that the COVID era was virtually over, and the Indian economy could now look forward to normalization. In preparing the ground for this normalization, the budget spelled out certain bold moves which included: (a) postponement and eventual re-examination of India's approach to fiscal consolidation, (b) significant changes in expenditure priorities, and (c) a clear move towards budgetary transparency by including some important off-budget borrowing onto the budget. In this review of the FY22 union budget, we examined the contours of budgetary balance, the changes in expenditure priorities, and the longer-term prospects of fiscal management and growth. Some major initiatives pertaining to non-tax revenues in the FY22 budget included spectrum sales and setting up of a National Monetization Pipeline for monetization of government and public sector owned assets, including defence assets. In this writeup, it was noted that unless the growth rate in union government's GTR increases to 10% or above on a sustained basis, and revenues from non-tax sources become buoyant, the reliance on larger fiscal deficit may become necessary for some more years.

Introduction

Union Budget FY22, the first post-COVID budget prepares the ground for the recovery of growth and economic activities. It implicitly assumes that the COVID era is virtually over, and the Indian economy can now look forward to normalization. In preparing the ground for this normalization, the budget spells out certain bold moves which include: (a) postponement and eventual re-examination of India's approach to fiscal consolidation, (b) significant changes in expenditure priorities, and (c) a clear move towards budgetary transparency by including some important off-budget borrowing onto the budget. In this review of the FY22 union budget, we examine the contours of budgetary balance, the changes in expenditure priorities, and the longer-term prospects of fiscal management and growth.

Achieving budgetary balance: Revision of fiscal consolidation norms

Constrained by a falling revenue receipts-GDP ratio even prior to the onset of COVID and the COVID-induced erosion of growth has led the fiscal authorities to suddenly relax on the target of fiscal deficit in the medium-term in order to prioritize fiscal support to growth. This called for a sharp jump in the fiscal deficit-GDP ratio of the central government from a budgeted level of 3.5% to 9.5% in the RE for FY21 facilitating an y-o-y expenditure growth of 28.4% in FY21 (Table 13.1). Thus, clearly, a significant fiscal stimulus has been provided in FY21 largely based on borrowing. In fact, in FY21, the magnitude of union government's fiscal deficit at INR18.5 lakh crore exceeded union government's non-debt receipts including tax and non-tax revenues at INR16 lakh crore. This has happened for the first time in India's fiscal history at least since 1970s. The upsurges in the level of fiscal deficit relative to GDP in FY21 (RE) and FY22 (BE) would have implications for union government's debt-GDP ratio and the stream of future interest payments. One redeeming feature of this large departure from norms is that a good part of this fiscal deficit is proposed to be spent on capital expenditure. However, in FY21 (RE), the share of capital expenditure in fiscal deficit has remained limited to close to 24%. The level of fiscal deficit is to be brought down to 6.8% of GDP in FY22 (BE), and in graduated steps, further to 4.5% of GDP by FY26. This is based on the suggestion of the Fifteenth Finance Commission (15th FC). With such a medium-term slippage, there would be an increase in the debt-GDP ratio and a clear need to re-examine the path of fiscal consolidation given India's current empirical realities. The issue of fiscal consolidation is examined later in this write-up.

Table 13.1: Budgetary balance: Union government's broad fiscal aggregates

#	Item	FY19	FY20	FY21 (RE)	FY22 (BE)	FY20 over FY19	FY21 (RE) over FY20	FY22 (BE) over FY21(RE)
		INR lakh crore				% growth (y-o-y)		
1	Gross tax revenue	20.8	20.1	19.0	22.2	-3.4	-5.5	16.7
2	Net tax revenues	13.2	13.6	13.4	15.5	3.0	-0.9	14.9
3	Non-tax revenues	2.4	3.3	2.1	2.4	38.8	-35.6	15.4
4	Non-debt capital receipts	1.1	0.7	0.5	1.9	-39.2	-32.2	304.3
5	Non-debt receipts (2+3+4)	16.7	17.5	16.0	19.8	5.2	-8.6	23.4
6	Fiscal deficit	6.5	9.3	18.5	15.1	43.8	98.0	-18.5
7	Total expenditure (8+9)	23.2	26.9	34.5	34.8	16.0	28.4	1.0
8	Revenue expenditure	20.1	23.5	30.1	29.3	17.1	28.1	-2.7
9	Capital expenditure	3.1	3.4	4.4	5.5	9.1	30.8	26.2

#	Item	FY19	FY20	FY21 (RE)	FY22 (BE)	FY20 over FY19	FY21 (RE) over FY20	FY22 (BE) over FY21(RE)
		INR lakh crore				% growth (y-o-y)		
10	Capital outlay	2.8	3.1	3.3	5.1	11.4	6.7	54.7
					% to GDP	percentage points		
1	Gross tax revenue	11.02	9.88	9.75	9.95	-1.14	-0.12	0.19
2	Net tax revenues	6.97	6.67	6.90	6.93	-0.31	0.23	0.03
3	Non-tax revenues	1.25	1.61	1.08	1.09	0.36	-0.53	0.01
4	Non-debt capital receipts	0.60	0.34	0.24	0.84	-0.26	-0.10	0.60
5	Non-debt receipts (2+3+4)	8.82	8.61	8.22	8.87	-0.21	-0.39	0.65
6	Fiscal deficit	3.44	4.59	9.49	6.76	1.15	4.90	-2.73
7	Total expenditure (8+9)	12.26	13.20	17.71	15.63	0.94	4.51	-2.08
8	Revenue expenditure	10.63	11.55	15.46	13.14	0.92	3.91	-2.31
9	Capital expenditure	1.63	1.6	2.3	2.5	0.02	0.60	0.23
10	Capital outlay	1.5	1.5	1.7	2.3	0.05	0.18	0.60
	Memo	INR lakh crore				% growth		
	Nominal GDP	188.9	203.5	194.8	222.9	7.8	-4.3	14.4

Source (Basic data): Union Budget documents (various years)

Expenditure shares: Priorities and discretionary fiscal space

Changes in expenditure priorities in FY21 (the COVID year) and FY22 (the first post-COVID year) can be captured by looking at the shares in total expenditures of important expenditure heads and their respective changes. It is notable that interest payments and pensions, two major heads of committed expenditures have accounted for 25.8% in FY21 (RE) and 28.5% in FY22 (BE) (Table 13.2). In the COVID year, there was a major increase in the expenditure share for agriculture and rural development which went up by 8.7 percentage points in FY21 (RE). This may be well-justified on the grounds of increased spending under MGNREGA and direct benefit transfers to Pradhan Mantri Jan Dhan Yojana (PMJDY) women account holders. These one-time increases in FY21 (RE) have been discontinued in FY22 (BE) resulting in a fall in the share of agriculture by (-)7.1 percentage points in FY22 (BE). This fall in FY22 has permitted an increase in the share of health in total expenditure by 1.5 percentage points, but the share of interest payments has also increased by 3.3 percentage points. One positive feature is that the share of capital expenditure in total expenditure has increased by 3.2 percentage points in FY22 (BE). A prioritization of capital expenditure and health expenditure are welcome steps.

Table 13.2: Composition of union government's expenditure: Expenditure items as a percentage of total expenditure

Items	FY18	FY19	FY20	FY21 (RE)	FY22 (BE)	FY21 minus FY20	FY22 minus FY21
	% of total expenditure					percentage points	
Total expenditure	100.0	100.0	100.0	100.0	100.0	0.0	0.0
Revenue expenditure *of which*	**87.7**	**86.7**	**87.5**	**87.3**	**84.1**	**-0.2**	**-3.2**
General services	**45.2**	**45.8**	**42.5**	**36.0**	**39.3**	**-6.5**	**3.3**
Interest payments	24.7	25.2	22.6	19.9	23.0	-2.7	3.1
Administrative services	4.0	4.3	4.1	3.1	3.3	-1.0	0.2
Pensions	6.8	6.9	6.8	5.9	5.4	-0.9	-0.5
Defence services	8.7	8.4	7.7	6.1	6.1	-1.7	0.0
Other general services	1.1	1.0	1.3	1.0	1.4	-0.3	0.4
Social services	**4.4**	**4.4**	**4.8**	**4.7**	**5.5**	**-0.1**	**0.7**
Education	1.9	1.6	1.6	1.3	1.4	-0.3	0.1
Health*	1.0	0.9	1.1	1.0	2.5	0.0	1.5
Other social services	1.5	1.9	2.1	2.4	1.6	0.3	-0.9
Economic services	**19.8**	**19.6**	**20.0**	**29.8**	**21.3**	**9.7**	**-8.4**
Agriculture and Rural dev.	10.3	10.4	11.5	20.2	13.1	8.7	-7.1
Industry and Minerals	3.1	3.2	3.0	3.4	2.6	0.4	-0.7
Transport and communication	2.0	1.9	1.3	1.5	1.2	0.2	-0.3
Other economic services	4.4	4.1	4.3	4.6	4.3	0.4	-0.3
Grants-in-aid	**17.4**	**15.9**	**18.4**	**14.7**	**16.0**	**-3.7**	**1.3**
Other grants	0.4	0.6	1.3	1.7	1.7	0.4	-0.1
Expenditure of UTs	0.4	0.4	0.4	0.4	0.4	0.0	0.0
Capital expenditure	**12.3**	**13.3**	**12.5**	**12.7**	**15.9**	**0.2**	**3.2**
Capital outlay of which	11.4	12.1	11.6	9.6	14.8	-2.0	5.1
General services	**5.0**	**4.9**	**4.6**	**4.2**	**4.3**	**-0.5**	**0.2**
Defence services	4.2	4.1	4.1	3.9	3.9	-0.2	0.0
Other general services	0.7	0.8	0.5	0.3	0.5	-0.2	0.2
Social services	0.4	0.4	0.4	0.2	0.2	-0.1	0.0
Economic services	6.0	6.7	6.5	5.1	10.0	-1.5	4.9
Roads and bridges	2.5	3.0	2.6	2.5	2.9	-0.1	0.4
Railways	2.0	2.3	2.5	0.8	3.1	-1.7	2.2
Other economic services	1.4	1.4	1.4	1.7	4.0	0.3	2.3
Expenditure of UTs	0.1	0.1	0.1	0.1	0.2	0.1	0.0
Loans and advances	0.8	1.2	0.9	3.1	1.2	2.2	-1.9

Source (Basic data): Union Budget documents (various years)
* includes expenditure on medical, Public health, family welfare, water supply and sanitation

Tax revenues

A major fiscal challenge relates to the performance of union government's GTR which have contracted in two successive years namely, FY20 and FY21 (RE) (Table 13.3).

a. Composition of gross tax revenues

The share of CIT both in FY21 and in FY22 in union government's GTR remains below its share in FY19 which was close to 32% (Table 13.3). The share of PIT is shown to marginally increase to slightly above 25% in FY22 (BE). Compared to FY19, the share of GST remains effectively unchanged but the share of union excise duties which indicates levy of central excise duty on petroleum products has increased to 15.1% in FY22 (BE) from 11.2% in FY19. Thus, the government appears to have relied on taxing the petroleum products to partially make up for the loss in the CIT revenues.

Table 13.3: Composition of gross tax revenues (shares in %)

Items	FY18	FY19	FY20	FY21 (RE)	FY22 (BE)	*FY22 (BE) - FY19 (% pts.)*
Gross tax revenue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	***0.0***
Direct taxes	**52.2**	**54.6**	**52.2**	**47.6**	**50.0**	***-4.7***
Corporation tax (CIT)	29.8	31.9	27.7	23.5	24.7	*-7.2*
Taxes on income (PIT)	22.4	22.7	24.5	24.2	25.3	*2.6*
Indirect taxes	**47.5**	**45.1**	**47.5**	**52.1**	**49.7**	***4.6***
Customs	6.7	5.7	5.4	5.9	6.1	*0.5*
Union excise duties	13.5	11.2	12.0	19.0	15.1	*4.0*
Service tax	4.2	0.3	0.3	0.1	0.0	*-0.3*
GST	23.1	28.0	29.8	27.1	28.4	*0.5*
CGST	10.6	22.0	24.6	22.7	23.9	*1.9*
IGST	9.2	1.4	0.5	0.0	0.0	*-1.4*
GST Compensation Cess	3.3	4.6	4.8	4.4	4.5	*-0.1*
State's share in GTR	**35.1**	**36.6**	**32.4**	**28.9**	**30.0**	***-6.6***
Union government's net tax revenue	**64.7**	**63.3**	**67.5**	**70.8**	**69.7**	***6.4***

Source (Basic data): Union Budget documents (various years)

b. From gross to net tax revenues

It is notable that the state's share in union government's GTR has only been 28.9% in FY21 (RE) and 30.0% in FY22 (BE) as compared to the recommended share of 41% in the divisible pool of central taxes. This is largely the result of the role of cesses and surcharges that are not sharable with the states.

Table 13.4: Cesses and surcharges of the central government

Items	FY18	FY19	FY20	FY21 (RE)	FY22 (BE)	FY21 *minus* FY19	FY22 *minus* FY19
In INR lakh crore							
Gross tax revenues	19.2	20.8	20.1	19.0	22.2	-1.8	1.4
Net tax revenue	12.4	13.2	13.6	13.4	15.5	0.3	2.3
State's share in central taxes	6.7	7.6	6.5	5.5	6.7	-2.1	-1.0
Divisible pool	16.1	16.1	16.3	13.4	16.2	-2.7	0.1
Cesses and surcharges (excl. GST Compensation Cess)	2.1	3.2	2.6	4.5	4.5	1.3	1.4
GST compensation cess	0.6	1.0	1.0	0.8	1.0	-0.1	0.0
	As % of GTR					% points	
Net tax revenue	64.7	63.3	67.5	70.8	69.7	7.4	6.4
State's share in central taxes	**35.1**	**36.6**	**32.4**	**28.9**	**30.0**	**-7.7**	**-6.6**
Divisible pool	84.1	77.6	80.9	70.6	73.2	-7.0	-4.4
Cesses and surcharges (excl. GST compensation cess)	10.8	15.3	12.7	23.8	20.5	8.5	5.2
GST compensation cess	3.3	4.6	4.8	4.4	4.5	-0.1	-0.1

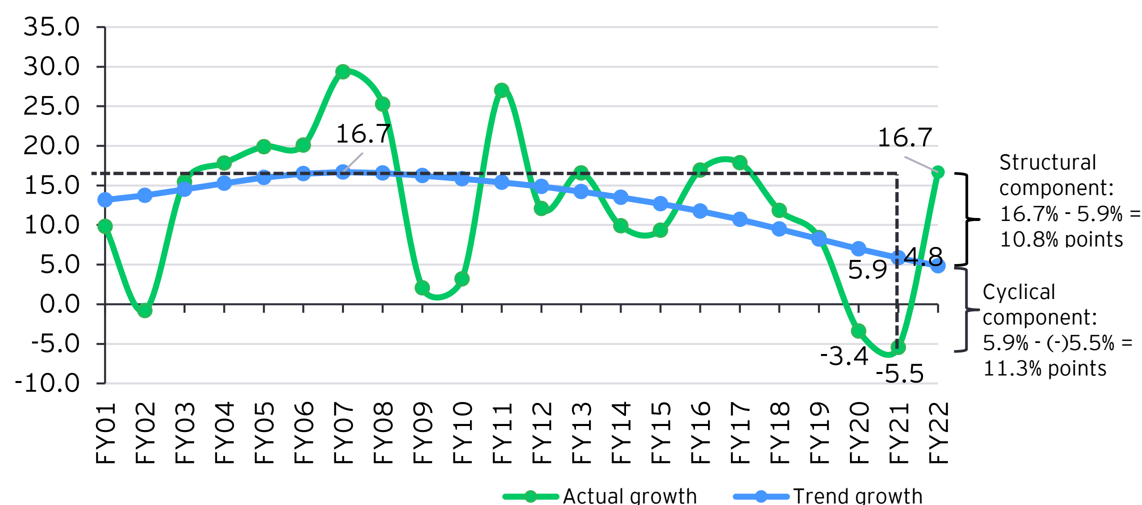
Source (Basic data): Union Budget documents (various years)

The sharp increase in the cesses and surcharges excluding GST compensation cess from INR2.6 lakh crore in FY20 to INR4.5 lakh crore in FY21 (RE) is mainly on account of road and infrastructure cess, and special additional excise duties on motor spirit **(Table 13.4).** Both relate to union excise duties on petroleum products.

c. Erosion of union government's GTR trend growth and recent troughs

A longer-term and critical issue in the management of India's public finances is the decline in the growth rate of union government's GTR on trend basis since FY08. After rising to about 16.7% in FY07, the trend growth rate of union government's GTR has fallen to 4.8% by FY22 (BE) (Chart 13.1). In the estimation of the trend growth rate, we have included the FY22 (BE) which shows an actual growth rate of 16.7% in union government's GTR. This could be due to a strong base effect since in the previous two consecutive years, there has been a contraction. But with a trend growth rate of 5% or less, union government's tax revenues remain quite weak. Unless the growth rate in union government's GTR increases to 10% or above on a sustained basis, the reliance on larger fiscal deficit may become necessary for some more years.

Chart 13.1: Union government's gross tax revenues: actual and potential growth (%)



Source (basic data): Union Budget FY22

Non-tax revenues

Some major initiatives have been unfolded in the FY22 budget regarding non-tax revenues. One critical item pertains to spectrum sales relating both to 4G and 5G which are likely to be brought on to the market in the last quarter of FY21 and in FY22. Another important initiative relates to the idea of monetization of government and public sector owned assets including defence assets. In the budget, a National Monetization Pipeline has been proposed as a first step towards assessing the potential value of government-owned assets and devising strategies for their monetization. Monetized government assets if leased or rented out, may yield a stream of periodic incomes which may be counted under non-tax revenues. However, outright sale of assets would generate one-time receipts and may be considered as part of government's non-debt capital receipts.

a. Composition of non-tax revenues

Reflective of the upcoming initiative on spectrum sales, the revenues under communication as percentage of total non-tax revenues has increased by 6.2 percentage points in FY22 (BE) over FY21 (RE) (Table 13.5). The only other major item where a significant increase in share is noticeable is dividends and profits from non-departmental undertakings (NDUs). Dividends from the RBI are shown to fall by a margin of (-)7.3 percentage points in FY22 (BE).

Table 13.5: Composition of non-tax revenues (shares in %)

Items	FY18	FY19	FY20	FY21 (RE)	FY22 (BE)	*FY22 - FY21 (% pts.)*
Non-tax revenues	100.0	100.0	100.0	100.0	100.0	*0.0*
Economic Services *of which*	31.8	35.6	31.1	36.4	41.3	*4.9*
Communication	16.6	17.3	21.3	16.0	22.2	*6.2*
Energy	6.1	6.6	4.1	6.1	6.0	*-0.1*
Dividends from RBI and FIs	23.3	29.9	46.0	29.3	22.0	*-7.3*
Dividends and profits from NDUs	24.1	18.3	10.9	16.5	20.6	*4.1*
Interest receipts	7.0	5.2	3.8	6.6	4.7	*-1.9*

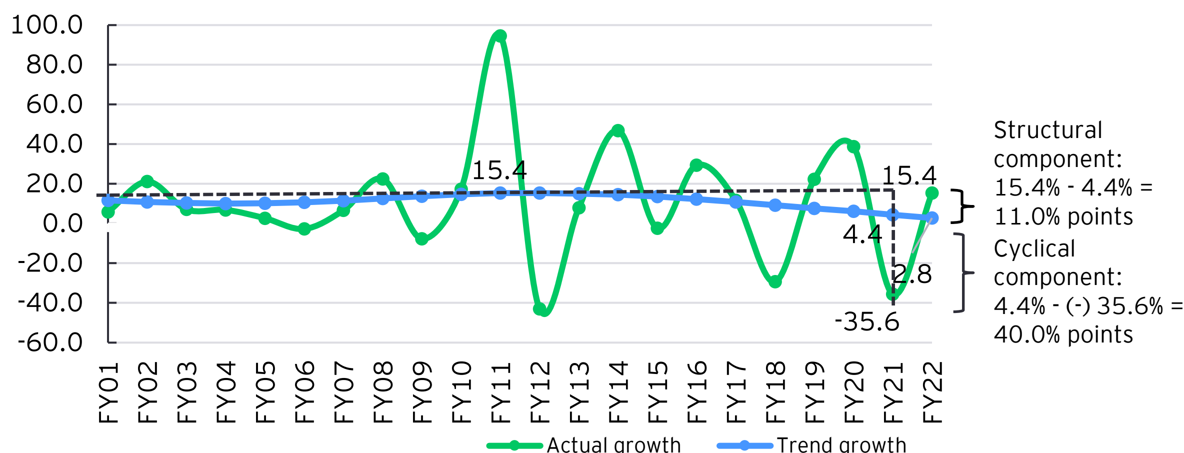
Items	FY18	FY19	FY20	FY21 (RE)	FY22 (BE)	*FY22 - FY21 (% pts.)*
General services	9.1	8.3	6.2	7.7	8.5	*0.8*
Social services	1.5	1.3	1.0	1.5	1.2	*-0.3*
Other services and sources	3.1	1.6	1.0	1.9	1.6	*-0.3*

Source (Basic data): Union Budget documents (various years)

b. Longer-term trend and volatility in non-tax revenues

A review of the performance of non-tax revenues over a longer period indicates a high degree of inter-year volatility around a falling trend growth rate. Its trend growth rate peaked at 15.4% in FY11 but has now fallen to 2.8% in FY22 (BE) (Chart 13.2). The reason for volatility relates to lumpy changes in different sources of non-tax revenues from time to time. Both dividends from RBI and spectrum auctions in selected years have led to such volatility in recent years. The sharp increase in growth to 15.4% projected for FY22 (BE) should be considered in the perspective of a sharp fall of (-)35.6% in FY21 (RE).

Chart 13.2: Union government's non-tax revenues: Actual and potential growth (%)



Source (basic data): Union Budget FY22

c. Asset monetization initiatives

Government owns resources on, below and above land as well as in the territorial waters (12 nautical miles or 22.2 km from the base line). However, a comprehensive enumeration or valuation of these resources is not publicly available. According to a media source[22], based on information provided by 41 of the 51 union ministries and 22 of over 300 PSEs to the union government in 2017, the government owns at least 13,505 square km. of land assets. Railways owns the highest land assets of 2,929 square km, followed by coal of 2,581 square km., and power of 1,807 square km. Similarly, there would be large land ownerships with the state and local governments. The central government in 2016, had launched the Government Land Information System (GLIS), a centralized database created by the ministry of electronics and information and monitored by the Prime Minister's Office (PMO) containing records of total land area, geo-positioning maps, and details such as ownership rights of land parcels.

[22] https://www.hindustantimes.com/india-news/how-much-land-does-indian-govt-own-officials-building-inventory-railways-biggest-landowner/story-NTUmFHp2xFXoB2lZRbv5TP.html

Ownership of minerals and water are equally valuable. Recent coal auctions have led to significant revenues for the state governments. Similarly, the central government has had some windfall gains through spectrum auctions. A study (CBGA, 2014) had estimated that the value of hydrocarbon and other mineral resources available in the country is at least INR5011.6 lakh crore[23]. This amounts to almost 25 times India's GDP at current prices in FY20. In order to exploit the revenue potential of these resources, new initiatives are needed. First, an exhaustive survey, enumeration and compilation of ownership records of these resources are needed. Second, a modern office to serve the role of an estate manager is called for. Third, a suitable policy is required to ensure inter-generational equity in the exploitation of this ownership of the government, for not only of the present generation but for all future generations.

Government of India has started bringing out an Asset Register under Rule 6 of the FRBM Rules, 2004. This list of assets does not include assets of the Cabinet Secretariat, Central Police Organisations, Ministry of Defence, and Department of Space and Atomic Energy. According to the Government of India's asset register, appended to the FY22 budget, the largest share in terms of value is that of land. It was 74.4% at the end of FY20. The Ministry of Defence as well as the Ministry of Railways may have ownership of huge tracts of land. The evaluation of assets is done in terms of historical prices. In the case of land, when historical prices are not available, these are evaluated at the notional price of INR1. Since the value of land appreciates, clearly the value of land owned by the government may be highly understated. Monetization of land requires proper evaluation of land and strategies for selling or leasing to generate returns. Land and real estate assets need to be evaluated on a scientific and dynamic basis for which specialized task forces are needed both at central and state levels. This is an exercise that would take time but would not only add to government revenues but to the overall productivity of the economy by making land available to the private sector for development and commercial use. It may be useful to set up a Land Commission to examine the possibilities and options. In this context, the idea of a National Monetization Pipeline is quite welcome although the time lag that may be required in the realization of any revenue inflows on this account remains unpredictable.

Non-debt capital receipts

Capital receipts within the budget accrue from two sources. These are government's net borrowing which is also referred to as the fiscal deficit, and non-debt capital receipts. Since fiscal deficit adds to government debt, it is considered a debt-related inflow. All other capital receipts are considered as part of non-debt capital receipts. Two major items in this pertain to disinvestment and recovery of loans and advances. Proceeds of sales of government assets would also be considered under this head.

a. Relative shares

Non-debt capital receipts are also characterized by considerable volatility and lumpiness. In FY22 (BE), the relative share of miscellaneous capital receipts/ disinvestment has increased by 24.3 percentage points (Table 13.6). The share of receipts under recovery of loans and advances, which has a relatively smaller magnitude, has correspondingly fallen to 6.9% in FY22 (BE). Total budgeted disinvestment receipts amounting to INR1.75 lakh crore in FY22 (BE) are divided broadly into financial and non-financial assets. Under the disinvestment of financial assets which includes a reduction in government's stake in public sector banks and financial institutions including LIC, the projected receipts amount to INR1.0 lakh crore.

[23] Kundu, S.,"A Note on the Estimated Value of Government-Owned Natural Resources in India", *Centre for Budget and Governance Accountability* (2014).

Table 13.6: Composition of non-debt capital receipts: Relative shares (%)

Items	FY18	FY19	FY20	FY21 (RE)	FY22 (BE)	FY22 - FY21 (% pts)
Total non-debt capital receipts	100.0	100.0	100.0	100.0	100.0	0.0
Recovery of loans and advances	13.5	16.0	26.7	31.2	6.9	-24.3
Miscellaneous capital receipts	86.5	84.0	73.3	68.8	93.1	24.3

Source (Basic data): Union Budget documents (various years)

Revisiting fiscal consolidation

The Economic Survey of FY21 prepared the background for justifying a sharp departure of union government's fiscal deficit in FY21 (RE) and FY22 (BE) from the corresponding FRBM norms and the medium-term path of the fiscal deficit that was stipulated in the FY21 Budget. This justification was based on a comparison of the nominal growth rate and the effective interest rate on government borrowing. As long as the nominal GDP growth is considerably higher than the effective interest rate, a relatively high primary deficit and fiscal deficit relative to GDP may be justified. The 15th FC had also examined this issue and had recommended a fiscal deficit of 6.5% of GDP for the union government for FY22. Their proposed path indicates a gradual reduction in the fiscal deficit to GDP ratio of the central government by an annual margin of 0.5 percentage points thereby reaching the level of 4.5% by FY26 (Table 13.7). The Commission also recommended that the FRBM norms may be examined afresh by a High-Powered Intergovernmental Group.

Table 13.7: Union government's fiscal deficit to GDP ratio - glide path

	FY20	FY21	FY22	FY23	FY24	FY25	FY26
FRBM Act 2018 (Union government)	--	3.0	3.0	3.0	3.0	3.0	3.0
FY21 Budget (Union government)	3.8	3.5	3.3	3.1	--	--	--
FY22 Budget (Union government)	--	9.5	6.8	--	--	--	4.5
FY22 Budget (States)	--	5.0*	4.5	--	3.0	3.0	3.0
15 FC (Union government)	--	7.4$	6.5	6.0	5.5	5.0	4.5
15 FC (States)	--	4.2$	4.5	4.0	3.5	3.5	3.0

Source (Basic data): Union Budget documents (various years), Report of the 15th Finance Commission
Note: the assessment by the 15th FC beginning FY22 for the fiscal deficit to GDP ratio for union government and states indicate the upper-end scenario (Tables 12.3 and 12.5, Volume 1, 15th FC report)
*subject to all states satisfying the prescribed conditions for additional borrowing
$Chapter 12 of Volume 1 of the Report of the 15th FC (Table 12.6, page no. 375)

In the medium-term fiscal policy cum fiscal policy strategy statement appended to the FY22 Budget, an estimation of government debt relative to GDP for the union government, which used to be given, has not been provided. According to our estimates, using the budget assumption regarding nominal GDP growth and the fiscal deficit numbers, union government's debt to GDP ratio is projected at 62.2% at the end of FY21 and 61.0% at the end of FY22. Also, the estimated combined debt-GDP ratio by end-FY21 and end-FY22 respectively are at 88.0% and 87.5%. At such

high debt-GDP levels, the burden of interest payment relative to GDP and relative to revenue receipts will become inordinately high thereby reducing the scope for primary deficit for any given level of fiscal deficit. In making international comparisons, we may note that for a number of developed countries, the general government debt-GDP ratio is projected to be higher than 100% by the end of 2020 and 2021 but in their case, the nominal interest rates are quite low, sometimes negative, and the revenue receipts to GDP ratios are much higher than that for India.

Concluding observations

The first post-COVID budget of the central government has favored a significant fiscal stimulus with a view to supporting recovery of real GDP growth from the trough of (-)7.8% in FY21. The sectoral priorities have been changed towards supporting growth. Additional allocations have been made for augmenting capital expenditure and health expenditure relative to GDP. The share of capital expenditure in total expenditure has increased by 3.2 percentage points to 15.9% in FY22 (BE). A qualitative improvement in budgeting practices relates to emphasis on transparency which involved bringing explicitly on to the budget, some of the food subsidies which were given to the FCI through NSSF.

A major fiscal challenge relates to the performance of union government's gross tax revenues which have contracted in two successive years namely, FY20 and FY21 (RE). A longer-term and critical issue in the management of India's public finances is the decline in the growth rate of union government's GTR on trend basis since FY08. After rising to about 16.7% in FY07, the trend growth rate of union government's GTR has fallen to 4.8% by FY22 (BE).

Some major initiatives pertaining to non-tax revenues in the FY22 budget include spectrum sales and setting up of a National Monetization Pipeline for monetization of government and public sector owned assets including defence assets.

Unless the growth rate in union government's GTR increases to 10% or above on a sustained basis and revenues from non-tax sources become buoyant, the reliance on larger fiscal deficit may become necessary for some more years. COVID-related challenges have led to a sharp increase in union government's fiscal deficit to unprecedented levels of 9.5% of GDP in FY21 (RE) and 6.8% of GDP in FY22 (BE). In fact, in FY21, the magnitude of union government's fiscal deficit at INR18.5 lakh crore exceeded union government's non-debt receipts covering tax and non-tax revenues at INR16 lakh crore. This has happened for the first time in India's fiscal history at least since 1970s. There is a need to return to a sustainable fiscal consolidation path as soon as feasible. The budget has indicated that the fiscal consolidation framework would be re-examined with a view to amending the FRBM Act. The impact of large fiscal deficits of the central and state governments in FY21 and beyond will be felt on increased levels of debt relative to GDP and correspondingly increased levels of interest payments relative to GDP and to government revenue receipts.

Chapter 14
Budget 2022-23: Budgeting for a normalizing economy: pushing infrastructure, returning to fiscal consolidation (February 2022)

Abstract

FY23 was the first normal year after the onslaught of COVID-19, which virtually eliminated meaningful increase in economic output during the two-year period covering FY21 and FY22. To become a global growth leader, in the medium-term, India's economy needed to sustain a real GDP growth rate of 7-7.5% FY23 onwards. In the FY23 Union Budget, the reorientation of government expenditure in favor of capital expenditure was expected to support India's medium to long-term growth. Alongside, the budget also clearly signaled restoration of fiscal consolidation. Apart from initiatives such as the GatiShaki, states were also incentivized to increase their capital expenditure. Other key initiatives included: (a) extension of the concessional CIT rate on newly incorporated domestic manufacturing companies until 31 March 2024, (b) improved budgetary transparency through discontinuation of off-budget expenditures, and (c) proposed taxation regime for digital assets along with the potential introduction of Digital Rupee based on blockchain and other related technologies.

Introduction

FY23 is expected to be the first normal year after the onslaught of COVID-19 which virtually eliminated meaningful increase in economic output during the two-year period covering FY21 and FY22. Beginning FY23, it would be critical for the Indian economy to sustain a medium-term real GDP growth ranging from 7-7.5% for emerging as the global growth leader.

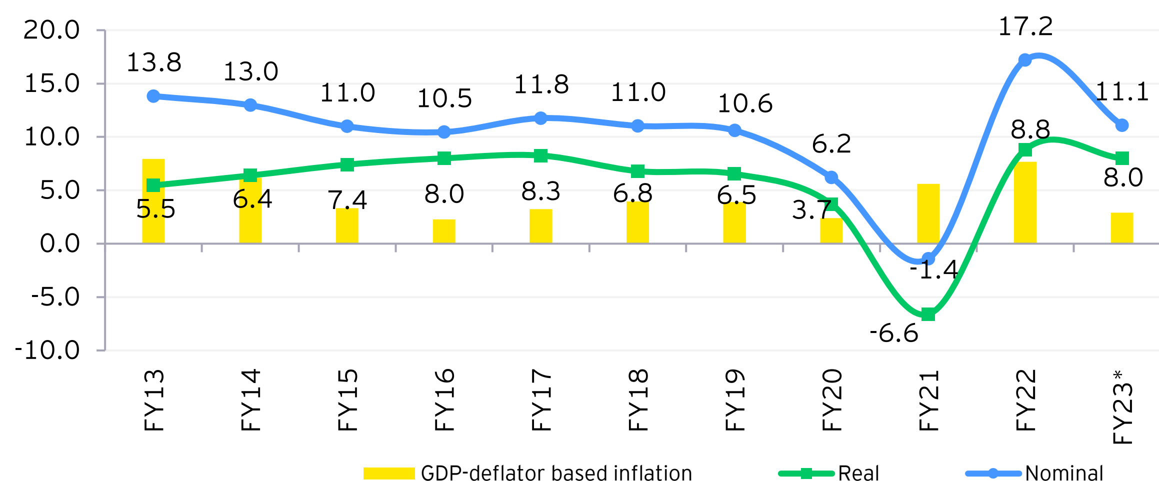
Recovery and growth prospects

In this section, we discuss the extent and nature of recovery beginning FY23 and the medium-term growth prospects of the Indian economy.

a) *Extent and nature of recovery*

In order to arrive at the latest GDP numbers, it is important to take into consideration, the National Statistical Office's (NSO) revised estimates of national accounts for FY19, FY20 and FY21 released on 31 January 2022, and the first advance estimates (FAE) for FY22 released on 7 January 2022. Chart 14.1 shows that the Indian economy had started slowing down even before the onset of the pandemic. From a peak of 8.3% in FY17, real GDP growth fell year after year, reaching 3.7% in FY20, the year just preceding the COVID year.

Chart 14.1: Real and nominal GDP growth (%, annual)



Source (basic data): MoSPI, Economic Survey FY22 and Union Budget FY23
*Real GDP growth is as per the lower limit of the range (8-8.5%) provided by the Economic Survey FY23. Nominal growth is sourced from the Union Budget FY23. Implicit price deflator (IPD)-based inflation rate is calculated using these real and nominal growth rates.

A similar downward trend was observed for nominal GDP growth over the three years preceding the pandemic. It is notable that after the latest data revisions by the NSO, the slowdown in FY20 was sharper than estimated earlier. The FY20 real growth has been revised downwards to 3.7% as against the earlier estimate of 4.0%. Further, in FY21, the contraction at (-)6.6% is lower as compared to (-)7.3% estimated earlier. Real GDP growth is estimated to recover to 8.8% in FY22. This estimate is based on combining the FAE for FY22 with the first revised estimate for FY21.

Table 14.1: Real and nominal GDP (INR lakh crore)

Fiscal year	Nominal	Real
FY20	200.7	145.2
FY21	198.0	135.6
FY22 (FAE)	232.1	147.5
FY23	258.0^	159.3#
CAGR (FY22 over FY20)	*7.5%*	*0.8%*
CAGR (FY23 over FY20)	*8.7%*	*3.1%*

Source: MoSPI, Economic Survey FY22 and Union Budget FY23
 # estimated using the lower end of real growth range at 8.0% as given by the Economic Survey 2021-22; ^Budget assumption

The estimated growth rebound in FY22 is just enough to offset the contraction in FY21 with a marginal positive growth over FY20. In fact, the magnitude of real GDP at INR147.5 lakh crore in FY22 is only slightly higher than INR145.2 lakh crore in FY20, implying a CAGR of 0.8% over FY20 (Table 14.1). Thus, the Indian economy has lost almost two years of real growth due to the adverse impact of COVID-19.

b) Growth: FY23 and beyond

With regard to India's growth prospects in FY23 and beyond, there are differing views amongst multilateral institutions, rating agencies, the Economic Survey 2021-22 (ES) and the RBI. Among the various forecasts available for FY23 real growth, the IMF's projection at 9.0% is the highest while the lowest projection at 6.5% is by the UN (Table 14.2). The RBI, in its February 2022 monetary policy review projects the FY23 growth at 7.8%. The ES projects India's real GDP growth to range between 8-8.5% in FY23. The lower end of this range, that is, 8.0% may be considered close to the median growth estimate by various institutions and agencies for FY23. In the medium term, as per the IMF, India's growth is projected in the range of 6-7%. In our assessment, maintaining a medium-term growth of 7-7.5% would establish India as the global growth leader. This would call for a sustained and strong fiscal support to growth.

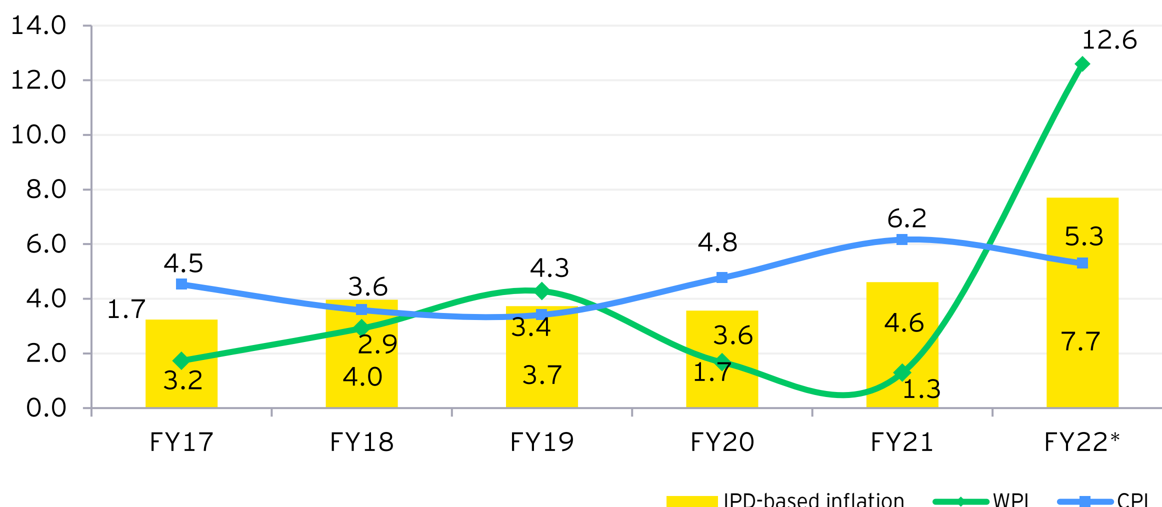
Table 14.2: India's real GDP growth prospects: forecasts by major institutions and agencies

Year	FY22	FY23	FY24	FY25	FY26	FY27
IMF	9.0	9.0	7.1	6.3	6.2	6.1
World Bank	8.3	8.7	6.8	--	--	--
Economic Survey 2021-22	--	8-8.5	--	--	--	--
OECD	9.4	8.1	5.5	--	--	--
RBI*	--	7.8	--	--	--	--
CRISIL	--	7.8	--	--	--	--
ADB	9.7	7.5	--	--	--	--
UN	8.4	6.5	5.9	--	--	--

Source (Basic data): IMF, OECD, ADB, World Bank, UN, Economic Survey FY22, RBI and media sources
Note: (1) The IMF forecasts for FY22, FY23 and FY24 are taken from the January 2022 update of the WEO and the forecasts for FY25, FY26 and FY27 are sourced from the October 2021 issue of the WEO
(2) FY23 column is colored to indicate the growth prospects for the upcoming fiscal year.
*February 2022 monetary policy statement

The Union Budget FY23 does not explicitly give an estimate for real GDP growth. However, it provides a nominal GDP growth estimate for FY23 at 11.1%. Taking the ES's lower end of real GDP growth at 8% along with the nominal growth assumed in the Budget, the implied implicit price deflator (IPD)-based inflation stands at 2.9% in FY23. This is significantly below the IPD based inflation in FY22 estimated at 7.7%. The implied fall in the IPD-based inflation rate is premised on a substantial fall in the WPI inflation rate which has averaged rather high at 12.6% over April 2021 to January 2022 (Chart 14.2).

Chart 14.2: CPI, WPI and IPD-based inflation (%, y-o-y)



Source (basic data): MoSPI
* For FY22, CPI and WPI inflation is for the period April 2021 to January 2022.

This upsurge in WPI inflation has been driven by high prices of global crude and primary products as also supply-side bottlenecks. These trends are not likely to be reversed in a short span of time. Thus, assuming a higher IPD-based inflation rate and accordingly a higher nominal growth rate would have been more realistic, leading to the creation of some valuable additional fiscal space. This is discussed in detail subsequently.

Sectoral perspectives

This section discusses the performance of major demand aggregates and output sectors in the last four years from FY19 to FY22.

a) Demand side

In the pandemic year of FY21, a contraction was witnessed in all demand segments except GFCE which had shown a growth of 3.6% reflecting government's large fiscal stimulus. In FY22, all segments are estimated to show a positive growth, enabling a recovery in the overall GDP growth. In terms of magnitude, in FY22, all segments except PFCE are estimated to exceed their corresponding levels in FY20. PFCE is estimated to remain below its pre-pandemic level in FY22 by INR(-)1.8 lakh crore (Table 14.3). Given that PFCE accounted for an average share of 56.2% in real terms during FY16 to FY20, policy should focus on facilitating recovery in private consumption demand.

Table 14.3: Real GDP growth: demand segments (%, annual)

Aggregate demand	FY19 (3rd RE)	FY20 (2nd RE)	FY21 (1st RE)	FY22 (FAE)	FY22 (FAE) minus FY20 (INR lakh crore)
PFCE	7.1	5.2	-6.0	4.1	-1.8
GFCE	6.7	3.4	3.6	11.0	2.2
GFCF	11.2	1.6	-10.4	17.4	2.4
EXP	11.9	-3.4	-9.2	23.0	3.3
IMP	8.8	-0.8	-13.8	29.5	3.9
GDP	**6.5**	**3.7**	**-6.6**	**8.8**	**2.4**

Source: MoSPI

b) *Output side*

On the output side, all sectors except agriculture and financial, real estate et. al. contracted in the COVID-year of FY21. It is notable that the revision to NSO data has resulted in a positive GVA growth of 2.2% in financial, real estate et. al. in FY21 as against a contraction of (-)1.5% estimated earlier.

Table 14.4: Real GVA growth: Output sectors (%, annual)

Aggregate demand	FY19 (3rd RE)	FY20 (2nd RE)	FY21 (1st RE)	FY22 (FAE)	FY22 (FAE) minus FY20 (INR lakh crore)
Agri.	2.1	5.5	3.3	3.5	1.4
Ming.	-0.8	-1.5	-8.6	14.6	0.2
Mfg.	5.4	-2.9	-0.6	5.5	1.1
Elec.	7.9	2.2	-3.6	14.7	0.3
Cons.	6.5	1.2	-7.3	8.8	0.1
Trans.	7.2	5.9	-20.2	15.0	-2.2
Fin.	7.0	6.7	2.2	0.9	0.9
Publ.	7.5	6.3	-5.5	13.8	1.3
GVA	**5.8**	**3.8**	**-4.8**	**7.4**	**3.0**

Source: MoSPI

In FY22, all sectors have shown a positive growth. Despite showing the highest growth among all GVA sectors, the magnitude of real GVA of the trade, transport et. al. sector in FY22 is estimated to remain below its FY20 level by INR(-)2.2 lakh crore (Table 14.4). Since this sector is highly contact-intensive and also has a large share of MSMEs, it would require immediate and large policy support. As per the ES, MSMEs contributed 33.1% in nominal terms to the overall GVA in FY20, indicating their relative importance in the overall output.

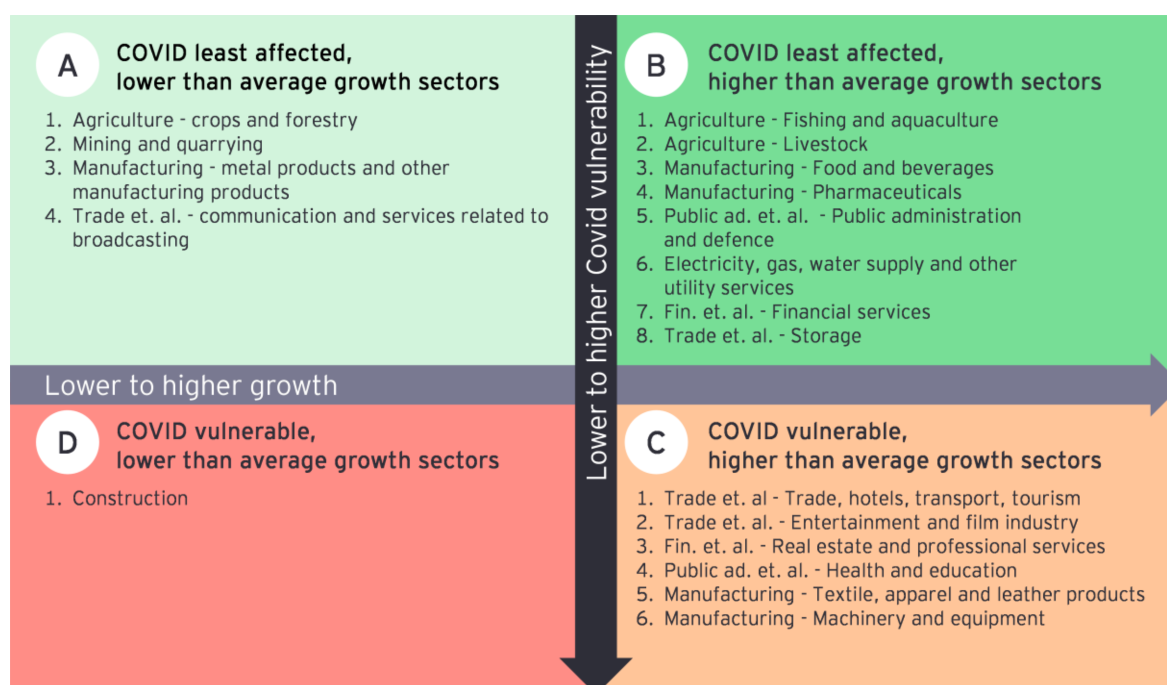
c) *Disaggregated perspective*

In order to further decipher the nature of policy support, the eight output sectors have been disaggregated into 19 subsectors. These subsectors as shown in Chart 14.3, have been arranged in four groups using a 2X2 classification. On the X-axis, sectors are arranged according to their historical medium-term growth performance relative to the overall GVA growth during the five

years (FY16 to FY20) preceding the COVID year of FY21. These are arranged from lower to higher growth. On the Y-axis, sectors are arranged to reflect lower to higher COVID vulnerability.

Agriculture has been divided into three subsectors, manufacturing into five, trade et. al. into four, financial, real estate et. al. and public administration, defence et. al. into two subsectors each. Three sectors have been retained as they /are namely, construction, mining and quarrying and electricity, gas., water supply et. al. Bringing together, growth performance along with COVID vulnerability helps in identifying sectors that require policy attention on a priority basis. Thus, construction can be seen as the most adversely affected sector since its average growth is lower than the overall GVA growth, and it has proved to be highly vulnerable to COVID. It is an employment-intensive sector and has in fact, received the highest policy attention both in the FY22 and FY23 Union Budgets. Sectors placed in group B have come out from COVID's impact with minimal adverse effect. Some of these sectors may have even prospered as a result of COVID such as the IT-based sectors in financial services et. al. sector, communication and broadcasting services in the trade et. al. sector and pharmaceuticals in the manufacturing sector.

Chart 14.3: A 2X2 representation of GVA sectors according to medium-term historical growth and COVID vulnerability



Source: EY representation

The agricultural sector consisting of crops and forestry is characterized by an average medium-term growth of 4.3% (FY16 to FY20). This sector remained relatively less adversely affected by COVID in FY21 and FY22 with its real GDP growth averaging at 3.4%. Its lower-than-average GVA growth performance however affects the income levels of rural population dependent on output of crops. Since there is considerable seasonal unemployment and underemployment in agriculture, this segment of population has required income support through schemes like MGNREGA. In the context of rural population, some of the non-agricultural rural activities may be linked to manufacturing, particularly food and beverages (sector 3. in group B) and textile, apparel and leather products (sector 5 in group C) and the trade et. al. relating to MSME and the informal sectors (sector 1. in group C). These sectors did require considerable policy support from the government during FY21 and FY22 and would require further support in FY23.

Most other sectors would be uplifted along with an increase in the overall growth rate. Indirectly, we can also draw some insights regarding increasing PFCE from this sectoral analysis. Rural

demand has been weak due to relatively low average income levels and increased unemployment in the contact-intensive sectors covering MSMEs and unorganized economic activities. Multiple COVID waves led to increased saving for precautionary motive. As employment and income levels increase in these sectors with the weakening of the impact of COVID, PFCE may pick up. Until that happens, demand support should still come from maintaining reasonably high levels of GFCE. The anticipated multiplier effects through infrastructure expansion would help augment employment and income levels but its impact on consumption would be visible only with a time lag. With these economy-related perspectives, we consider the role that the union government's FY23 Budget may play in FY23 and in the medium-term.

Union government's FY23 budget

Union government's FY23 budget has introduced some key structural changes. First, it has clearly accorded a higher priority to capital expenditure in total expenditure. Second, within the composition of capital expenditure, it has provided greater emphasis on non-defence capital outlay. Alongside, the Budget has signaled a restoration of fiscal consolidation.

a) Fiscal balance: Returning to consolidation

From a peak of 9.2% of GDP in FY21, union government's fiscal deficit has been reduced to 6.9% in FY22 (RE) and is budgeted to be further brought down to 6.4% in FY23. The Budget, in its Medium-Term Fiscal Policy cum Fiscal Policy Strategy Statement indicates reaching the level of 4.5% by FY26 (Table 14.5).

Table 14.5: Debt and deficit profile of the government

	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Union government's fiscal deficit to GDP ratio (%)							
FY23 Budget	--	9.2	6.9	6.4	--	--	4.5
15 FC (2nd Report)	--	--	6.5	6.0	5.5	5.0	4.5
Debt to GDP ratio (%)							
Union government	51.0*	62.2	59.6	60.0	--	--	--
Combined	74.6	89.9	87.3	88.5	--	--	--

Source (basic data): Union Budgets; Report of the Fifteenth Finance Commission, Union government's FRBM Act (2018), EY estimates from FY22 onwards; *sourced from Economic Survey 2021-22

Union government's debt is estimated at 60% of GDP at the end of FY23, 20 percentage points above the FRBM target of 40%. Further, the combined debt-GDP ratio is estimated at 88.5% at the end of FY23. The path of downward adjustment of debt depends on the profile of fiscal deficit, nominal GDP growth and the effective interest rate. The interest rate has a key role in determining the ratio of interest payments to revenue receipts. This ratio would remain under pressure as long as debt relative to GDP is high. In fact, domestic interest rates may be pushed up, at least in the short run, due to global pressures also since money is flowing back to the US and other developed countries as their interest rates have been increasing. A careful calibration of the fiscal consolidation path in the medium and long term is called for as part of a reliable fiscal strategy. Therefore, there is a need to constitute a new FRBM Committee as suggested by the Fifteenth Finance Commission.

b) Budgetary balance

Table 14.6 shows the broad contours of budgetary aggregates. Central government's total expenditure is budgeted to grow only by 4.6% in FY23, lower than 7.4% and 30.7% in FY22 and FY21 respectively. Thus, the strength of the fiscal stimulus is somewhat limited and the Budget banks on imparting structural shifts to improve the impact of the limited fiscal stimulus.

Table 14.6: Fiscal aggregates in FY22 and FY23: broad contours

Item	FY20	FY21	FY22 (RE)	FY23 (BE)	FY21 over FY20	FY22 (RE) over FY21	FY23 (BE) over FY22(RE)
	% to GDP				% growth		
Gross tax revenues	**10.0**	**10.2**	**10.8**	**10.7**	**0.8**	**24.1**	**9.6**
Net tax revenues	6.8	7.2	7.6	7.5	5.1	23.8	9.6
Non-tax revenues	1.6	1.1	1.4	1.0	-36.5	51.1	-14.1
Non-debt capital receipts	0.3	0.3	0.4	0.3	-16.0	73.5	-20.7
Fiscal deficit	**4.7**	**9.2**	**6.9**	**6.4**	**--**	**--**	**--**
Total expenditure	**13.4**	**17.7**	**16.2**	**15.3**	**30.7**	**7.4**	**4.6**
Revenue exp.	11.7	15.6	13.6	12.4	31.2	2.7	0.9
Capital exp.	1.7	2.2	2.6	2.9	27.0	41.4	24.5
Memo	INR lakh crore				% growth		
Nominal GDP	**200.7**	**198.0**	**232.1**	**258.0**	**-1.4**	**17.2**	**11.1**

Source (basic data): MoSPI, Union Budgets

Total expenditure is budgeted at 15.3% of GDP in FY23 that is to be financed by net tax revenues, non-tax revenues and non-debt capital receipts. The remaining gap is to be financed by union government's borrowings that are budgeted at 6.4% of GDP in FY23.

Union government's gross tax revenues (GTR) are budgeted to grow by 9.6% in FY23 after a strong growth of 24.1% in FY22 (RE). A contraction is budgeted for both non-tax revenues and non-debt capital receipts in FY23. In particular, the magnitude of disinvestment receipts budgeted at INR65,000 crore for FY23 appears relatively realistic given the amounts realized through this channel in the recent years. In fact, the FY22 RE for disinvestment proceeds has also been revised down to INR78,000 crore from the BE of INR1.75 lakh crore.

c) *Government expenditures: Prioritizing capital expenditure*

The FY23 Budget provides a tangible shift in favor of expanding capital expenditure which is budgeted to increase to 2.9% of GDP in FY23 from 2.6% in FY22 **(Table 14.7)**. This is a welcome change. Growth in capital expenditure at 24.5% in FY23 is significantly higher than that in revenue expenditure at 0.9%. This also implicitly improves the quality of fiscal deficit since a much higher proportion of 45.2% of fiscal deficit is earmarked for capital expenditure in FY23. Within capital expenditure, capital outlay is also structured in favor of non-defence outlay which has a higher multiplier effect.

Table 14.7 shows the structure of union government's expenditure in terms of major components of revenue and capital expenditures. The share of capital expenditure in total expenditure is budgeted to increase to 19.0% in FY23 (BE) from 16.0% in FY22 (RE). Within capital expenditure, non-defence capital outlay relative to total expenditure is budgeted to increase to 11.6% in FY23 (BE) from 10.8% in FY22 (RE).

Table 14.7: Structure of expenditure: revenue and capital

Expenditure items	FY19	FY20	FY21	FY22 (RE)	FY23 (BE)
	% of total expenditure				
Revenue expenditure	**86.7**	**87.5**	**87.9**	**84.0**	**81.0**
Interest payments	25.2	22.6	19.1	21.4	23.8
Pensions	6.9	6.8	5.9	5.3	5.3
Defence services	8.4	7.7	5.9	6.1	5.9
Education	1.6	1.6	1.2	1.3	1.4
Medical, public health et.al.	0.9	1.1	1.0	2.8	2.5
Capital expenditure of which	**13.3**	**12.5**	**12.1**	**16.0**	**19.0**
Capital outlay	**12.1**	**11.6**	**9.0**	**14.5**	**15.5**
Capital outlay on non-defence	8.0	7.5	5.2	10.8	11.6
Capital outlay on defence	4.1	4.1	3.8	3.7	3.9
Memo items					
Subsidies as a % of total expenditure	*16.5*	*16.1*	*40.7*	*21.5*	*14.6*
Interest Payments as % of revenue receipts	*37.5*	*36.3*	*41.6*	*39.1*	*42.7*
Total expenditure as a % of GDP	*12.2*	*13.4*	*17.7*	*16.2*	*15.3*

Source (basic data): MoSPI, Union Budgets

d) Increasing interest payments, falling subsidies

Committed expenditures of the government largely include interest payments, salaries and pensions, and subsidies. Interest payments, pensions and subsidies together are budgeted to pre-empt 43.6% of total expenditure in FY23 (Table 14.7). In fact, the share of interest payments in revenue receipts is correctly budgeted to increase to 42.7% in FY23 as compared to 39.1% in FY22 (RE) as this is linked to the relatively high debt-GDP ratio of the central government as well as on the combined account of union government and states. With respect to subsidies, there is a reduction in the budgeted amount to 14.6% of total expenditure in FY23 from 21.5% in FY22 (RE). This is premised on the assumption that it would be feasible to bring down major subsidies including food, fertilizer and petroleum. However, since these subsidies are linked to global crude prices, a downward adjustment may not come about in the near future. Given this, growth in government's revenue expenditure that is budgeted at less than 1% in FY23 may have been underprovided.

Revenue receipts: Scope for upward revision

Table 14.8 shows that union government's GTR are estimated to grow by 24.1% in FY22 (RE). This indicates achieving a buoyancy of 1.4. In FY23 (BE) however, the buoyancy has been brought down to 0.9. Given the expanded digitization and formalization of the economy and the tax assessees, union government's tax buoyancy may turn out to be higher than 0.9 in FY23. If the underassessment in both tax buoyancy and nominal GDP growth assumptions is marginally corrected to say, 1.1 and 13% respectively, union government's GTR would have shown a more realistic growth of 14.3%. In fact, there may be another source providing scope for upward revision of the estimates of union government's GTR in FY23. CGA's data up to December 2021 indicates that in the first nine months of FY22, collections of union government's GTR at INR19.3 lakh crore

has already covered 76.7% of RE which is nearly 9 percentage points higher than the corresponding average ratio at 68% during the last five years (FY17 to FY21).

Table 14.8: Central tax revenues: growth and buoyancy

Fiscal Year	Direct tax of which	CIT	PIT	Indirect taxes	Gross taxes
Growth (%, y-o-y)					
FY19	13.4	16.2	9.8	2.9	8.4
FY20	-7.7	-16.1	4.2	1.8	-3.4
FY21	-10.0	-17.8	-1.1	12.7	0.8
FY22 (RE)	32.3	38.7	26.2	17.0	24.1
FY23 (BE)	13.6	13.4	13.8	5.7	9.6
Buoyancy					
FY19	1.3	1.5	0.9	0.3	0.8
FY20	-1.2	-2.6	0.7	0.3	-0.5
FY21	7.3	13.0	0.8	-9.3	-0.6
FY22 (RE)	1.9	2.2	1.5	1.0	1.4
FY23 (BE)	1.2	1.2	1.2	0.5	0.9

Source (basic data): MoSPI, Union Budgets

Seasonality studies[24] indicate that the January-March quarter usually experiences a peak growth in tax revenue collections particularly for direct taxes. Although account has to be taken of the likely fall in the growth of revenues from union excise duties due to a reduction in the specific rates on petroleum products[25], the weight of direct taxes is much higher than that of union excise duties. In fact, a contraction to the extent of (-)14.5% in GTR in the last quarter of FY22 would be required to realize the FY22 RE for union government's GTR. If, in fact, the union government does better than this RE, the resultant additional revenues would come in handy for increasing allocations for some of the underprovided sectors during the course of the year such as MGNREGA, health expenditures including vaccines and major subsidies.

Medium-term strategy: Reemphasizing infrastructure push

The structural shift towards infrastructure expansion is visible in the FY23 Budget. There is a clear emphasis on uplifting capital expenditure which is associated with relatively higher output and employment multipliers. Further, as part of loans and advances within capital expenditure, the union government has made a provision for extending an interest-free loan amounting to INR1 lakh crore to the states for undertaking infrastructure expansion over and above the normal borrowing limit. The normal borrowing limit for states itself has been extended to 4% of GDP for FY23 of which 0.5 percentage points is linked to power sector reforms. This is a timely initiative since central government often finds itself administratively constrained to accelerate infrastructure expansion as most of the relevant subjects are under states' supervision. In fact, up to December 2021, as per

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[24] Srivastava, D. K., and Ragini Trehan. "Managing Central Government Finances: Asymmetric Seasonality in Receipts and Expenditures." Global Business Review 19.5 (2018): 1322-1344.

[25] On 3 November 2021, the Central government had announced the reduction of excise duty on petrol and diesel by INR5 and INR10 respectively, with effect from 4 November 2021. https://www.pib.gov.in/PressReleasePage.aspx?PRID=1769306

CGA's data, the central government could undertake capital expenditure of only 65% of the annual RE.

The Budget speech has elaborated a proposal to undertake a seven-pronged initiative over a period of 25 years to accelerate movement of goods and people in India (GatiShakti). These seven initiatives pertain to roads, railways, airports, ports, mass transport, waterways, and logistics infrastructure. Successful implementation of such a plan would provide infrastructural support for achieving high-medium-term growth. It would be useful to fully integrate the already existing six-year National Infrastructure Pipeline (NIP) framework with the new GatiShakti initiative.

Conclusion: Some salient hits and misses of Budget FY23

The Union Budget for FY23 has clearly signaled restoration of fiscal consolidation. The reorientation of government expenditure in favor of capital expenditure is expected to support India's medium to long term growth. Apart from initiatives such as the GatiShaki, states have also been incentivized to increase their capital expenditure. Other key initiatives include: (a) extension of the concessional CIT rate on newly incorporated domestic manufacturing companies until 31 March 2024, (b) improved budgetary transparency through discontinuation of off-budget expenditures, and (c) proposed taxation regime for digital assets along with the potential introduction of digital Rupee based on blockchain and other related technologies.

It is also useful to take note of some gaps. The Budget may have left unutilized fiscal space on account of a possible underassessment of base magnitude, nominal GDP growth, and tax buoyancy. This additional fiscal space could have been utilized for augmenting allocations for some of the underprovided sectors such as MGNREGA, health expenditures including vaccines and major subsidies. This could also have been utilized for expanding the limited support that the FY23 Budget has provided to the MSMEs. Alternatively, this could have facilitated an accelerated pace of fiscal consolidation.

Chapter 15

Budget 2023-24: Laying foundations for a robust medium-term growth and fiscal consolidation (February 2023)

Abstract

GoI's FY24 budget was prepared in the background of major supply side disruptions and a slowdown in global growth. The Economic Survey of 2022-23 had projected a real GDP growth in the range of 6-6.8%. This was much lower than the targets being discussed in the previous budgets. The nominal GDP growth assumption was also brought down to 10.5%. The buoyancy of GoI's GTR was kept at 1. Constraints on revenue growth induced extensive expenditure side reforms favoring growth of GoI's capital expenditures while containing growth of revenue expenditures. There was a substantive reduction in major subsidies comprising food, fertilizer and petroleum, and a near-stagnation in social sector expenditures, including health and education.

Introduction

GoI's FY24 Budget gave a direct push to growth through sharply accelerating infrastructure spending in the wake of global economic slowdown and continuing geopolitical uncertainties. While supporting growth, the GoI also signalled resumption of fiscal consolidation by reducing its fiscal deficit to GDP ratio from 6.4% in FY23 (RE) to 5.9% in FY24 (BE). The assumed nominal GDP growth at 10.5% even with a GTR buoyancy of 1 is estimated to lead to a tightening of fiscal resources in FY24 relative to FY23. As a result, growth of revenue expenditure has been limited to mere 1.2% in FY24 (BE) primarily owing to a substantive reduction in major subsidies comprising food, fertilizer and petroleum, and a near-stagnation in social sector expenditures including health and education. We assess the FY24 Budget in the context of India's short- and medium-term growth prospects.

Global growth prospects

According to the IMF, the world economy would suffer a slowdown, showing a fall in global growth to 2.9% in 2023 as compared to 3.4% in 2022 (Table 15.1). These growth rates, based on the January 2023 update of the IMF's World Economic Outlook are however marginally better as compared to its October 2022 projections. The global growth forecasts as per IMF's October 2022 release were at 2.7% for 2023. Thus, while the global economic situation has improved, it is still constrained by a continuing economic slowdown. Growth rates of major economies/regions are expected to fall across the board in 2023. India is no exception in this context although it remains a global growth leader among major economies in all the three years namely 2022, 2023 and 2024 (FY23, FY24 and FY25 for India).

Table 15.1: Global growth projections (IMF)

Country	2022	2023	2024
AEs	**2.7**	**1.2**	**1.4**
US	2.0	1.4	1.0
Euro area	3.5	0.7	1.6
Japan	1.4	1.8	0.9
UK	4.1	-0.6	0.9
EMDEs	**3.9**	**4.0**	**4.2**
Brazil	3.1	1.2	1.5
Russia	-2.2	0.3	2.1
India*	6.8	6.1	6.8
China	3.0	5.2	4.5
World	**3.4**	**2.9**	**3.1**

Source (basic data): IMF World Economic Outlook, January 2023 update; *fiscal year basis

With a global demand slowdown, demand for India's exports is also expected to be affected adversely. In FY23, the contribution of net exports to real growth is estimated to be negative at (-) 2.8 percentage points. This is due to a much lower growth in exports at 12.5% as compared to a higher imports growth at 20.9%. The current account deficit (CAD) relative to GDP in 1HFY23 was at 3.3% and is expected to improve in 2HFY23. For the full year of FY23, it may turn out to be close to 3%. Although global growth would slow down further in 2023, commodity prices may also fall. The price effect may be larger than the trade magnitude effect, and both net exports and CAD may perform better in FY24 as compared to FY23.

Underlying assumptions

Three critical underlying parameters informing the budget estimates relate to assumptions with respect to 1) real GDP growth, 2) inflation as measured by the IPD which in turn reflects a weighted average of CPI and WPI inflation rates, and 3) global crude and commodity prices. These assumptions are not explicitly stated in the Budget. In the Medium-Term Fiscal Policy Cum Strategy Statement (MTFP), the government is required to provide its medium-term growth and fiscal outlook. The GoI abstained from doing so citing global economic uncertainties as the main reason. It has however estimated the nominal GDP growth at 10.5% for FY24, significantly lower than 15.4% in FY23 as per NSO's First Advance Estimates. This implies that the Budget assumes that both real GDP growth and inflation would fall in FY24 from their levels in FY23. Possibly, the fall in IPD-based inflation may be steeper due to an anticipated fall in global crude prices. This is reflected in a sharp fall in the budgeted magnitude of major subsidies in FY24 (BE) by (-)28.2%. Assuming that there is a moderation of 3.9 percentage points in the IPD-based inflation rate from 7.9% in FY23 to 4% in FY24, the real GDP growth would fall by a lower margin of nearly 1% point from 7% to 6-6.2% over this period.

Table 15.2: India's growth prospects for FY24 (%)

Year	Eco Survey	RBI (Feb2023)	IMF	World Bank	OECD
FY24	6.5 (6-6.8)	6.4	6.1	6.6	5.7

Source: Economic Survey 2022-23, Union Budget FY24, RBI, IMF, World Bank, and OECD

The RBI, in its February 2023 monetary policy review, has indicated a real growth projection of 6.4% and CPI inflation expectation at 5.3% (Table 15.2). It has indicated that risks to commodity prices and core inflation remain due to supply disruptions and geopolitical tensions.

Another critical budget parameter pertains to the overall and individual tax buoyancies. In FY23 (RE), the expected buoyancy of GoI's GTR is 0.8. In FY24, the GTR buoyancy is budgeted to increase to 1. This is mainly dependent on the budgeted increase in the buoyancy of UED from (-) 1.2 in FY23 (RE) to 0.6. The buoyancies of individual tax revenue components namely, PIT, CIT, and GST are estimated to be slightly lower in FY24 as compared to their levels in FY23.

Overall balance: Accommodating deficit reduction

The GTR of the GoI is budgeted at 11.14% of GDP in FY24, the same level as in FY23. The net tax revenues relative to GDP are however budgeted to increase marginally which reflects some adjustment in states' share in GoI's GTR **(Table 15.3)**. This increase amounts to 0.08 percentage points of GDP. An additional 0.04 percentage points were added to GoI's net revenue receipts on account of non-tax revenues. Thus, GoI's net revenue receipts are budgeted to increase by 0.12 percentage points of GDP in FY24 as compared to FY23. Non-debt capital receipts are budgeted to fall by 0.03 percentage points in FY24. Thus, in order to accommodate a reduction in fiscal deficit of 0.5 percentage points of GDP, a reduction in total expenditure to GDP ratio to the extent of 0.41 percentage points has been necessitated. Furthermore, capital expenditure has been increased by 0.65 percentage points. Thus, the total burden of adjustment has been shouldered by revenue expenditure which has fallen by 1.06 percentage points. The stimulus to growth therefore comes from a change in the composition of expenditure in favor of capital expenditure.

Table 15.3: GoI's fiscal aggregates in FY23 and FY24: Broad contours

Item	FY22	FY23 (RE)	FY24 (BE)	FY24 minus FY23	FY22 over FY21	FY23 (RE) over FY22	FY24 (BE) over FY23 (RE)
	% to GDP			% pts. of GDP	% growth		
Net revenue receipts	**9.17**	**8.60**	**8.72**	**0.12**	**32.8**	**8.2**	**12.1**
Gross tax revenues	11.45	11.14	11.14	0.00	33.7	12.3	10.4
Net tax revenues	7.63	7.64	7.72	0.08	26.5	15.6	11.7
Non-tax revenues	1.54	0.96	1.00	0.04	75.8	-28.3	15.2
Non-debt capital receipts	0.17	0.31	0.28	-0.03	32.8	8.2	12.1
Fiscal deficit	**6.70**	**6.43**	**5.92**	**-0.51**	**--**	**--**	**--**
Total expenditure	**16.03**	**15.33**	**14.92**	**-0.41**	**8.1**	**10.4**	**7.5**
Revenue exp.	13.53	12.67	11.61	-1.06	3.8	8.1	1.2
Capital exp.	2.51	2.67	3.32	0.65	39.1	22.8	37.4
Memo	INR lakh crore				% growth		
Nominal GDP	**236.6**	**273.1**	**301.8**	**--**	**19.5**	**15.4**	**10.5**

Source: MoSPI and Union Budgets (various years)

Growth stimulating measures

Apart from the growth stimulating effect of an increase in GoI's capital expenditure, which is budgeted to grow by 37.4% in FY24 as compared to 22.8% in FY23 (RE), several provisions have been made in order to incentivize the state governments also to augment their capital expenditures. **First,** grants have been given to the states for capital asset creation amounting to 1.2% of GDP. **Second,** an interest-free loan for 50 years has been extended to states for capital expenditures in FY24. For this purpose, the GoI has provided an outlay of INR1.37 lakh crore. **Third,** the fiscal deficit limit of the states has also been retained at the higher level of 3.5% of GSDP for FY24 as compared to the FRBM target level of 3% of GSDP. Assuming that states fully utilize these facilities, the consolidated fiscal deficit of central and state governments would be 9.4% of GDP.

If all of the permitted fiscal deficit, that is, 3.5% of GDP is used by states for capital asset creation along with the additional 1.2% of GDP received as grants for the purpose of capital asset creation, total capital expenditures on account of states considered together would be 4.7% of GDP in FY24.

GoI's capital expenditure in FY24 can be estimated as their fiscal deficit (5.9% of GDP) net of revenue deficit (2.9% of GDP). This amounts to 3% of GDP. In addition, central public sector undertakings (PSUs) have investment plans amounting to 1.1% of GDP. Thus, public sector investment, considering central and state governments and central PSUs would be 8.8% of GDP.

Apart from capital expenditure expansion, indirectly, private final consumption expenditure may also be boosted as a result of an increase in disposable incomes especially of the lower middle-

income groups through tax slab adjustments[26]. An expected moderation in inflation would also add to disposable real incomes. Further, lower global crude prices would imply a lowering of energy costs for households, releasing incomes for augmenting expenditure on non-energy products. Private investment expenditure may also be boosted by a resumption of an interest rate reduction cycle after further fall in inflation. In its February 2023 monetary policy review, the RBI has increased the repo rate by 25 basis points to 6.5%. There is no indication as yet whether this is the peak policy rate, or another increase may be considered in the forthcoming April 2023 meeting which would be the first meeting of FY24. However, as inflation comes down and the US Fed also decelerates or halts its interest rate hike cycle, conditions may be created for repo rate reduction in India.

Tax revenue performance

In FY23, GoI's GTR was budgeted to grow by 9.6% over FY22 (RE) with an underlying nominal growth assumption of 11.1% and a buoyancy of 0.9. Budgeted GTR turned out to be only 1.8% higher than the FY22 actuals. As against this, the estimated GTR growth in FY23 (RE) over FY22 actuals is 12.3%. This implies a buoyancy of 0.8 with an underlying nominal growth of 15.4% as per NSO's First Advance Estimates. Thus, FY23 (BE) was characterized by a significant underestimation.

Table 15.4: Tax revenue performance

Fiscal Year	DT of which	CIT	PIT	IDT of which	GST	UED	Customs	GTR	Nominal growth
Growth (%, y-o-y)									
FY20	-7.7	-16.1	4.2	1.8	3.0	3.7	-7.2	-3.4	6.2
FY21	-10.0	-17.8	-1.1	12.7	-8.3	62.8	23.3	0.8	-1.4
FY22	49.0	55.6	42.9	20.2	27.2	0.7	48.2	33.7	19.5
FY23 RE)	17.2	17.3	17.1	7.1	22.3	-18.9	5.1	12.3	15.4
FY24 (BE)	10.5	10.5	10.5	10.4	12.0	5.9	11.0	10.4	10.5
Buoyancy									
FY20	-1.2	-2.6	0.7	0.3	0.5	0.6	-1.2	-0.5	
FY21	7.3	13.0	0.8	-9.3	6.1	-46.0	-17.1	-0.6	
FY22	2.5	2.8	2.2	1.0	1.4	0.04	2.5	1.7	
FY23 (RE)	1.1	1.1	1.1	0.5	1.5	-1.2	0.3	0.8	
FY24 (BE)	1.0	1.0	1.0	1.0	1.1	0.6	1.0	1.0	

Source: Union Budgets and MoSPI
Note: negative buoyancies should not be interpreted

In FY24 (BE), the nominal GDP growth rate has been reduced to 10.5% while GoI's GTR buoyancy has been increased to 1 (Table 15.4). Achieving a buoyancy of 1 is predicated on an increase in the revenue growth of UED from (-)18.9% in FY23 (RE) to 5.9% in FY24 (BE). The underlying assumption seems to be a substantive fall in global crude prices which might facilitate increasing the GoI's specific UED rates on petroleum products. Buoyancies of other major components of GoI's GTR namely, CIT, PIT, and GST are all indicated to fall. In the case of CIT and PIT, this fall is from

[26] The RBI, in its February 2023 Monthly Bulletin, estimates that the tax changes proposed in the Budget would provide additional household income to the tune of INR 35,000 crores. Using a tax multiplier of 1.16, it estimates a positive impact on real GDP growth of 0.15% points.

1.1 to 1. For GST, this fall is larger from 1.5 to 1.1. In the case of customs duties also, there is a substantive increase in the growth rate and buoyancy which may be anticipated in view of some upward rate revisions such as in the case of naptha, precious metals, toys, bicycles and vehicles.

States' share in central taxes

The Finance Commission recommends, under Article 270 of the Constitution, the share of states in the divisible pool of the sharable taxes. This pool consists of all taxes collected by the union government net of cesses and surcharges and cost of collection. This share was fixed at 42% by the Fourteenth Finance Commission (FC14). The Fifteenth Finance Commission (FC15) had lowered it to 41% in view of the reduced number of states from 29 to 28 with Jammu and Kashmir being notified as a union territory with legislature.

Table 15.5: States' recommended and effective share in GoI's GTR

Fiscal Year	Recommended share (%)	Effective share (%)	Difference (percentage points)
FY20	42	32.5	9.5
FY21	41	29.6	11.4
FY22	41	33.4	7.6
FY23 (RE)	41	31.4	9.6
FY24 (BE)	41	30.7	10.3

Source: Union Budgets, Finance Commission reports

A higher share of cesses and surcharges reduces the volume of the sharable taxes. This share indicates the portion of the net proceeds of union taxes which is excluded by the union government from sharing with the states. This has been kept on average close to 10 percentage points during FY20 to FY24 (BE) (Table 15.5). The effective share of states has thus been reduced to less than 31% in FY24 (BE) which is even lower than 32% as recommended by FC13. In a way, this effectively defeats the objective of FC14 of uplifting the states' share by 10 percentage points to 42%.

Expenditure side adjustments

The main structural adjustment in GoI's expenditure profile has been to uplift the share of capital expenditure in total expenditure. This has been increased from 15.6% in FY22 to 22.2% in FY24 (BE). Correspondingly, the share of revenue expenditure in total expenditure has fallen from 84.4% to 77.8% (Table 15.6). Viewed in growth terms, capital expenditure in FY24 (BE) has been increased by 37.4% over FY23 (RE) while revenue expenditure is budgeted to grow only at 1.2%. Such a sharp reduction in revenue expenditure growth is largely on account of a reduction in major subsidies which have been budgeted to contract by (-)28.2%. Since these subsidies are linked to global crude and commodity prices, such a large reduction may reflect GoI's implicit expectation of a sharp fall in these prices. The share of interest payments in total expenditure has been budgeted to increase to 24% from 22.5% in FY23 (RE). This is due to an increase in GoI's debt-GDP ratio in spite of a fall in the fiscal deficit to GDP ratio which is discussed in detail in Section 8 on fiscal consolidation.

Within capital expenditure, capital outlay is structured in favour of non-defence expenditure which has a higher multiplier effect. Its share is budgeted to increase to 15% in FY24, an increase of 3.8 percentage points over FY23 (RE).

Table 15.6: Structure of union government's expenditure: revenue and capital

Expenditure items	FY22	FY23 (RE)	FY24 (BE)	FY22	FY23 (RE)	FY24 (BE)
	% of total expenditure			% of GDP		
Revenue expenditure	**84.4**	**82.6**	**77.8**	**13.5**	**12.7**	**11.6**
Interest payments	21.2	22.5	24.0	3.4	3.4	3.6
Pensions and other Retirement Benefits	5.2	5.8	5.2	0.8	0.9	0.8
Major subsidies	11.8	12.5	8.3	1.9	1.9	1.2
Defence services	6.0	6.2	6.0	0.6	0.5	0.5
Education	1.2	1.2	1.2	0.2	0.2	0.2
Medical, public health et.al.	2.8	2.1	2.3	0.4	0.3	0.3
Capital expenditure *of which*	**15.6**	**17.4**	**22.2**	**2.5**	**2.7**	**3.3**
Capital outlay	14.1	14.8	18.6	2.3	2.3	2.8
Capital outlay on non-defence	10.5	11.2	15.0	1.7	1.7	2.2
Capital outlay on defence	3.6	3.6	3.6	0.6	0.5	0.5
Memo items						
Interest Payments as % of revenue receipts	37.1	40.1	41.0			

Source (basic data): Union Budget FY24 and MoSPI

Given such a large thrust on infrastructure expansion through the budget, it is useful to identify the beneficiary sectors as indicated in Table 15.7. The two main sectors that draw on GoI's resources are roads and bridges and the commercial lines of Indian railways. In terms of magnitude, there are sharp increases for petroleum and for north-eastern areas. However, their share in total infrastructure expenditure remains limited at 3.5% and 2.5% respectively.

Table 15.7: Ministry/Department wise allocation of capital expenditure: Major heads

Ministry/ Department	FY23 (RE)	FY24 (BE)	FY24 (BE) minus FY23 (RE)	Share in FY24 (BE)	Growth in FY24
	INR Crores			%	
Roads and Bridges	1,96,820	2,44,480	47,660	24.4	24.2
Railways - Commercial Lines	1,58,997	2,39,925	80,928	24.0	50.9
Defence Services	1,50,000	1,62,600	12,600	16.2	8.4
Other Communication Services	36,690	60,816	24,126	6.1	65.8
Petroleum	40	35,508	35,468	3.5	88,648
North-eastern Areas	15,359	24,842	9,483	2.5	61.7
Loans & advances to states	85,413	1,37,384	51,971	13.7	60.8

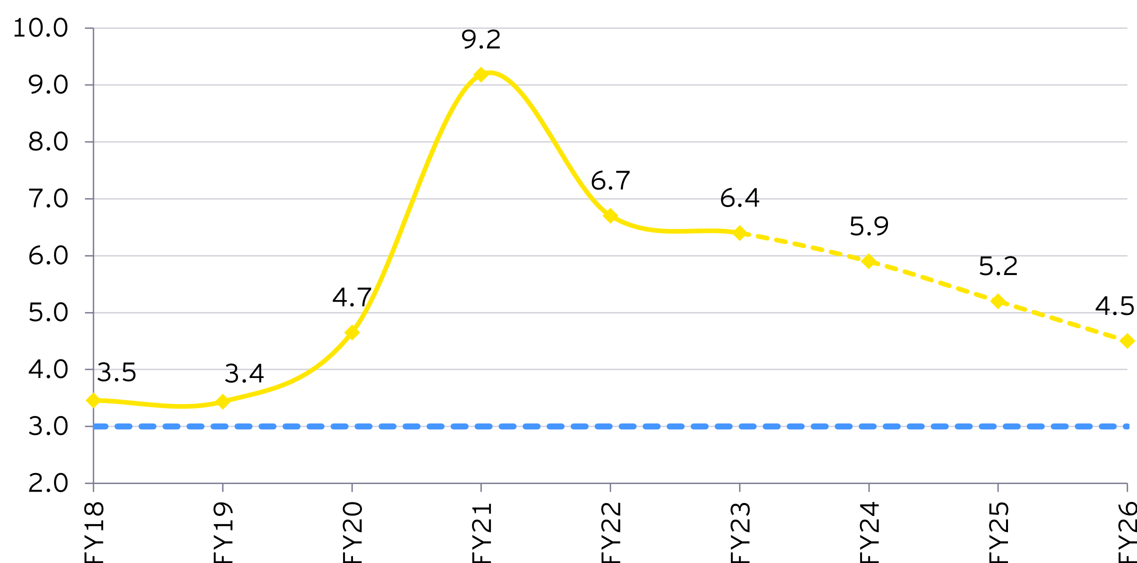
Ministry/ Department	FY23 (RE)	FY24 (BE)	FY24 (BE) minus FY23 (RE)	Share in FY24 (BE)	Growth in FY24
	INR Crores			%	
Others (residually derived)	84,954	95,406	10,452	9.5	12.3
Total	**7,28,274**	**10,00,961**	**2,72,687**	**100.0**	**37.4**

Source: Union Budget FY24

It is well known that the multiplier associated with capital expenditures tends to be high. According to a recent RBI Studyson[27], central government capital expenditure multiplier has been estimated at 2.45 and 3.14 in the first and second year respectively. This is the main reason that the GoI has argued that the FY24 Budget is growth stimulating in spite of the fact that the overall size of GoI's expenditure relative to GDP has fallen from 15.3% in FY23 (RE) to 14.9% in FY24 (BE).

Fiscal consolidation: Medium-term prospects

Chart 15.1: GoI's fiscal deficit relative to GDP - glide path



Source: Union Budgets

According to the FY23 (RE), the GoI would be able to realize its budgeted fiscal deficit to GDP target at 6.4% (Chart 15.1). Even after this, a considerable distance remains from the FRBM target of 3% of GDP. The government signalled its determination to move towards this target even though constrained by the ongoing global economic slowdown. Thus, it has budgeted a reduction of 0.5 percentage points of GDP, targeting to reach a level of 5.9% in FY24. GoI has also indicated that it intends to reach a level of 4.5% by FY26 implying that a reduction of 0.7 percentage points of GDP each would be required in the next two years. However, the GoI has not indicated the year by which it would reach the fiscal deficit target of 3% of GDP as per the FRBMA (2018). The FC15 had suggested setting up of a High-powered intergovernmental group to review the 2018 amendment of the FRBMA. Perhaps, this group may be able to examine the matter afresh.

[27] RBI Bulletin December 2020

Table 15.8: GoI's debt-GDP ratio (%)

	FY23 (RE)	FY24 (BE)
Union government	55.7	56.1

Source: Union Budget FY24

In the meanwhile, it may be noted that in spite of the fall in the fiscal deficit to GDP ratio, there is a rise in the GoI's debt-GDP ratio as indicated in Table 15.8. This is so mainly because of the sharp fall in the nominal GDP growth rate from 15.4% in FY23 to 10.5% in FY24 (BE). There is also a marginal increase in the effective interest rate from 6.9% in FY23 (RE) to 7.1% in FY24 (BE). This is expected in view of the condition of increase in the debt-GDP ratio between two successive years[28]. It is notable that the mandated debt-GDP target for the central government according to FRBMA (2018) is at 40%.

The importance of reducing the government debt-GDP ratio lies in its link with the saving-investment profile of the economy. Government borrowing is a claim on economy's available investible resources. There is one sector namely, the household sector which provides a surplus of its saving over its investment in the form of household sector financial savings. Available financial savings of the household sector currently amount to about 8% of GDP. Adding to this, net capital inflow from abroad of nearly 2.5% of GDP, total investible resources to the tune of 10.5% of GDP would be available. From this, if the central and state governments together draw 9.4% (5.9% plus 3.5%), the balance of only 1.1% would be available for the private sector and the non-government public sector. With such pre-emptive claims by the government on the limited investible resources, an environment of interest rate reduction and stimulus to private investment would become considerably difficult.

Conclusion

Even though the Budget acknowledges a fall in nominal (and real) GDP growth in FY24 largely due to the global headwinds, the GoI has utilized this opportunity to sustain the ongoing momentum for infrastructure expansion and strategic policy thrust to lay a solid foundation for medium to long term growth. Three aspects of these strategic policy priorities are notable. **First,** there has been an ambitious infrastructure expansion program as reflected in the National Infrastructure Pipeline, Gati Shakti, and the National Logistics Policy. The GoI has also endeavored to incentivize the state governments to augment their capital expenditures. **Second,** there has been a clear emphasis on supporting green growth. This is reflected in the ongoing Green Hydrogen Mission and initiatives in the current Budget including a Green Credit Program, PM-PRANAM (PM Programme for Restoration, Awareness, Nourishment and Amelioration of Mother Earth) and GOBARdhan scheme both for encouraging green fertilizers and discouraging chemical fertilizers, Bhartiya Prakritik Kheti Bio-Input Resource Centres, and MISHTI (Mangrove Initiative for Shoreline Habitats and Tangible Incomes). These initiatives will not only help India achieve its net zero carbon emission goal but also reduce dependence on imported chemicals and fertilizers. Third**,** the GoI is determined to achieve a strategic reduction in India's dependence on imported crude as the Indian economy has remained vulnerable to global crude price and supply instabilities. In this context, the current Budget has allocated funds for augmenting India's storage capacity for petroleum reserves and for diversification of sources of crude supply by facilitating investment by ONGC in other countries such as Venezuela, Russia and Columbia. There is also a continued shift towards exploiting non-conventional energy sources including solar, wind, ethanol and hydrogen.

[28] The relevant condition is that the debt-GDP ratio of year t (b_t) would be higher than that of the previous year (b_{t-1}) if the primary deficit to GDP ratio of the current year (p_t) is greater than the excess of nominal growth rate over effective interest rate ($g_t - i_t$) multiplied by $[b_{t-1}/(1+g_t)]$.

Chapter 16

Interim Budget 2024-25: Abiding by the Dharma of Vote on Account: Growth preserving fiscal consolidation (February 2024)

Abstract

This Interim Budget on the eve of general elections scheduled to be held in April and May 2024 showed considerable fiscal rectitude on the part of the government, which abstained from announcing any major fiscal giveaways. This self-discipline created the necessary fiscal space for prioritizing fiscal consolidation without sacrificing growth. The thrust towards capital expenditure was continued by budgeting its growth at 16.9%. The quality of fiscal deficit as measured by revenue deficit to fiscal deficit ratio had consistently improved from a level of 75% in FY18 to a budgeted level of 38.8% in FY25 (BE). The interim budget was to be followed by a full year budget after the elections.

Introduction

The GoI has done well to abide by the Dharma of Vote on Account. In spite of the general elections being round the corner, it resisted the temptation of making any large budgetary commitments for selected voter segments. In fact, allocations for major social sector schemes do not show any significant departure from normal increments to account for inflation. This self-discipline has created the fiscal space to prioritize fiscal consolidation while not sacrificing growth. In fact, as fiscal consolidation leads the Indian economy closer to the FRBM norms, it would solidify India's medium-term growth prospects.

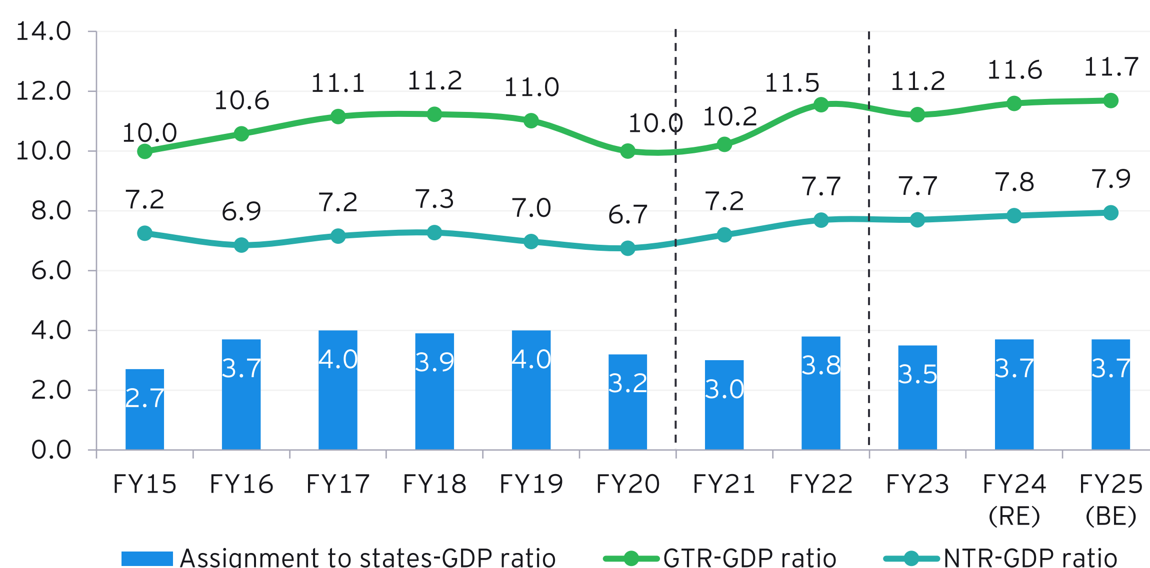
An assessment of fiscal reforms over 10 years: Selected dimensions

Other than an analysis of budgetary allocations and the arithmetic to achieve the reduction in fiscal deficit and debt relative to GDP, the FY25 Budget also provides an opportunity to assess the progress of fiscal reforms in the ten years under the guidance of the current government. Three notable aspects relate to (1) improvement on trend basis, in the tax-GDP ratio of the GoI as well on the consolidated account of central and state governments, (2) a persistent change in the structure of GoI's expenditure in favor of capital expenditures, and (3) sustained reduction in GoI's subsidy burden relative to GDP. These developments auger well for the fiscal consolidation roadmap as well as for creating fiscal room for growth and macro stabilization.

Improvement in tax-GDP ratio: GoI and the combined government

In the case of the tax-GDP ratio, we can consider the ten-year period in three distinct parts (**Chart 16.1**). The first part pertains to the first six years of the current government covering FY15 to FY20. The second part consists of two years subjected to the COVID shock and the subsequent recovery which contains the base effects. The remaining three years cover the period from FY23 to FY25 (BE). The first phase shows an inverted-U shape of GoI's tax-GDP profile. Starting from a relatively low level of 10% in FY15, GoI's gross tax revenue to GDP ratio increased on a consistent basis to 11.2% by FY18. This improvement in the post-demonetization period was largely due to improved compliance linked to increasing digitalization and formalization of the Indian economy. In the latter part of the first phase, two major tax reforms took place namely, transition to the Goods and Services Tax (introduced in July 2017 that is, FY18) and comprehensive Corporate Income Tax (CIT) reforms (introduced in September 2019 that is, FY20).

Chart 16.1: Trends in GoI's gross tax revenue (GTR) to GDP ratio (%)



Source (basic data): Union budget documents and MoSPI

Both led to certain revenue losses in the initial years, so much so that the GoI's tax-GDP ratio was back to 10% in FY20, the pre-COVID year. After that, two years were taken up by the COVID and its immediate aftermath affecting the GTR in FY21 and FY22. In FY22, the GoI's tax-GDP ratio increased to 11.5% reflecting a sharp economic recovery. After that, in the more normal years, the tax-GDP ratio incrementally rose from 11.2% in FY23 to 11.6% in FY24 (RE). It is projected to further increase to 11.7% in FY25 (BE) showing a steady upward movement.

The net tax revenue (NTR) relative to GDP indicates the share of GoI's GTR that accrues to the GoI. The excess of GTR over NTR mainly indicates tax revenues that are shared with the states[29]. In the case of the NTR-GDP ratio, there is a notable increase after FY20. The vertical columns indicate the pattern of change in the share of states in GoI's GTR relative to GDP. This share fell from 4% in FY19 to 3% in FY21. This fall was due both to a fall in the GoI's GTR to GDP ratio and an increase in the non-sharable central cesses and surcharges. In fact, if we look at the share of states in GoI's GTR, it fell from 36.6% in FY19 to 29.4% in FY21, the COVID year. However, an improvement in more recent years is visible when this share is shown to increase from 3.5% of GDP in FY23 to 3.7% in FY24 (RE) and FY25 (BE). This translates to an improvement in the share of states in GoI's GTR from 29.4% in FY21 to 31.1% in FY23 and further to 31.9% in FY24 (RE) and 31.8% in FY25 (BE).

Structure of GoI's total expenditure

A second major outcome of fiscal reforms during the last 10 years relates to an improvement in the structure of government expenditures as shown in Table 16.1. The period from FY15 to FY21 shows a near stable share of revenue expenditure in total expenditure in the range of 85.6% (FY17) to 88.2% (FY15). FY22 onwards, there has been a steady fall in the share of revenue expenditure so much so that over the entire period covering FY15 to FY25 (BE), there is a fall of 11.5 percentage points in this share from 88.2% to 76.7%. Correspondingly, there is an increase in the share of capital expenditure in total expenditure. This increase is especially pronounced for the period from FY21 to FY25 (BE) when it increased from 12.1% to 23.3%. Within capital outlay, there is a further trend of increase favoring non-defence expenditure which implies expenditure on infrastructure. The share of non-defence outlay in total expenditure rose from 5.2% in FY21 to 16.1% in FY25 (BE).

Table 16.1: Structure of GoI's total expenditure (share in total expenditure in %)

	FY 15	FY 16	FY 17	FY 18	FY 19	FY 20	FY 21	FY 22	FY 23	FY 24 (RE)	FY 25 (BE)
Revenue exp.	88.2	85.9	85.6	87.7	86.7	87.5	87.9	84.4	82.4	78.8	76.7
Interest	24.2	24.7	24.3	24.7	25.2	22.6	19.1	21.1	22.1	23.5	25.0
Defence	8.2	8.1	8.4	8.7	8.4	7.7	5.9	6.0	6.1	6.7	5.9
Capital exp.	11.8	14.1	14.4	12.3	13.3	12.5	12.1	15.6	17.6	21.2	23.3
Capital outlay	10.1	12.7	12.5	11.4	12.1	11.6	9.0	14.1	14.9	18.0	19.7
Non-defence	5.1	8.2	8.2	7.2	8.0	7.5	5.2	10.5	11.5	14.5	16.1
Defence	4.9	4.5	4.4	4.2	4.1	4.1	3.8	3.6	3.4	3.5	3.6

Source (basic data): Union budget documents and MoSPI

[29] A small component also pertains to the GoI's transfers to the National Calamity Contingency Fund

Table 16.2: Major social sector schemes

Social sector schemes	FY21	FY22	FY23	FY24 (RE)	FY25 (BE)	*FY25 (BE) minus FY24 (RE)*
	INR crore					
MGNREGA	1,11,170	98,468	90,806	86,000	86,000	-
Jal Jeevan Mission (JJM)/National Rural Drinking Water Mission	10,998	63,126	54,700	70,000	70,163	*163*
National Education Mission	40,260	25,305	32,875	33,500	37,500	*4,000*
National Health Mission	28,088	32,958	33,803	33,886	38,183	*4,297*
Pradhan Mantri Awas Yojna (PMAY)	37,478	90,020	73,615	54,103	80,671	*26,568*
Pradhan Mantri Gram Sadak Yojna	13,688	13,992	18,783	17,000	19,000	*2,000*
Pradhan Mantri Krishi Sinchai Yojna	7,877	11,278	6,380	8,781	11,391	*2,610*
Urban Rejuvenation Mission: AMRUT and Smart Cities Mission	9,754	13,868	15,153	13,200	10,400	*-2,800*
Pradhan Mantri Kisan Samman Nidhi (PMKisan)	60,990	66,825	58,254	60,000	60,000	-
Crop Insurance Scheme	14,161	13,549	10,296	15,000	14,600	*-400*
Total	3,34,464	4,29,389	3,94,665	3,91,470	4,27,908	*36,438*
Memo						
Total as % of total expenditure	*9.5*	*11.3*	*9.4*	*8.7*	*9.0*	
Total as % of primary expenditure	*11.8*	*14.4*	*12.1*	*11.4*	*12.0*	

Source (basic data): Union budget documents and MoSPI

In an interim budget, with general elections round the corner, it is often expected that the government of the day may announce various budgetary giveaways in order to appeal to the voters. However, the understood dharma of a 'Vote on Account' is that the government should not utilize the budget for making any major expenditure commitments. It is basically to be used only for

ensuring parliamentary approval for undertaking expenditures from 01 April 2024 to the date when the post-election government's full year budget is made effective. Table 16.2 gives details of budgetary allocation of major social sector schemes. It may be noted that the GoI's budget does not increase the allocation for major social sector schemes by any significant margin. As a percentage of primary expenditure, it has been kept at 12%, which is close to the average for the last four years.

GoI's major subsidies

One part of revenue expenditure reforms relates to subsidy reforms. The GoI has been able to show a steady reduction in major subsidies which were at its peak relative to GDP at 3.57% in the COVID year of FY21 (Table 16.3). Since then, this ratio has steadily fallen to 1.16% in FY25 (BE). In fact, the period from FY15 to FY20 witnessed a steady reform aimed at reducing the share of subsidies in GoI's revenue expenditure primarily by better targeting and delivery to the intended beneficiaries by using India's substantially improved public digital infrastructure.

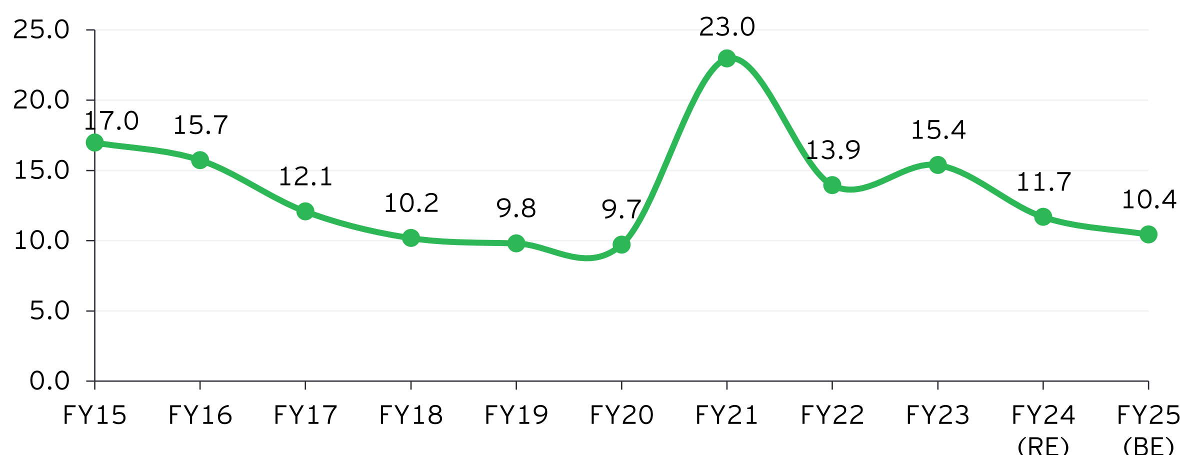
Table 16.3: Trends in major subsidies (% of GDP)

Year	Major subsidies of which	Fertilizer subsidy	Food subsidy	Petroleum subsidy
FY15	2.00	0.57	0.94	0.48
FY16	1.76	0.53	1.01	0.22
FY17	1.33	0.43	0.72	0.18
FY18	1.12	0.39	0.59	0.14
FY19	1.04	0.37	0.54	0.13
FY20	1.14	0.40	0.54	0.19
FY21	3.57	0.65	2.73	0.19
FY22	1.90	0.66	1.23	0.01
FY23	1.95	0.92	1.00	0.03
FY24 (RE)	1.39	0.64	0.72	0.04
FY25 (BE)	1.16	0.50	0.63	0.04

Source (basic data): Union budget documents and MoSPI

As a result, as a percentage of revenue expenditures, major subsidies fell from 17% in FY15 to 9.7% in FY20 (Chart 16.2). This was disturbed in the COVID year where there was a dire need to increase the extent of benefits and the ambit of beneficiaries. In that year, the share of major subsidies in GoI's revenue expenditure shot up to 23%. This includes the effect also of GoI's effort towards transparency by clearing any arrears of entities like Food Corporation of India and the Oil Marketing Companies. However, since then, it has progressively been brought down to 10.4% in FY25 (BE).

Chart 16.2: Share of major subsidies in GoI's revenue expenditure (%)

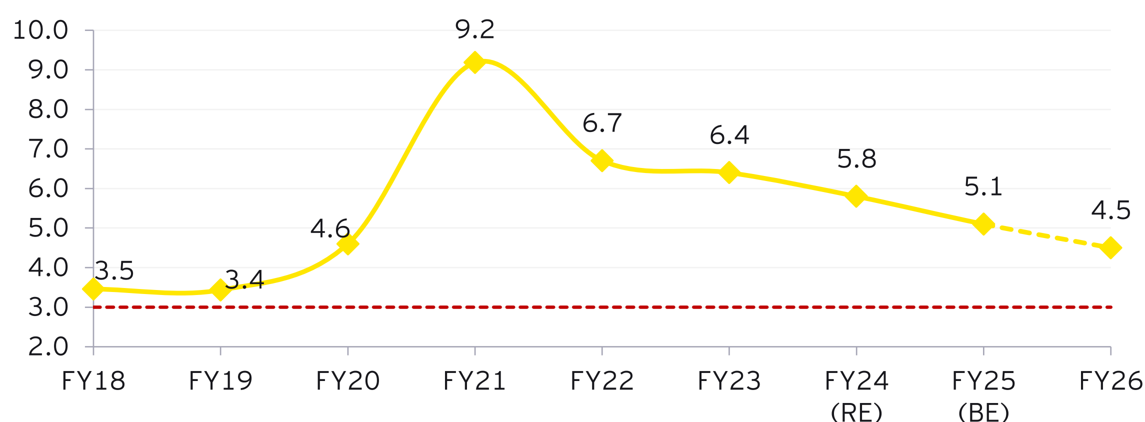


Source (basic data): Union budget documents

Fiscal consolidation: GoI's glide path

A major thrust of the interim budget was to signal that the GoI was serious about fiscal consolidation and was committed to restoring FRBM norms in regard to government debt and fiscal deficit which were disturbed by the onset of COVID. In fact, in FY19, the GoI's fiscal deficit was reduced to 3.4% (Chart 16.3) of GDP with a view to eventually reaching 3% as per the FRBM norms. However, partly as a result of comprehensive CIT reforms in FY20, there was a contraction in GoI's GTR to the extent of (-)3.4%. In this year, real and nominal GDP growth rates also fell to their respective pre-COVID troughs of 3.9% and 6.4%. Thus, the Indian economy faced COVID that unfolded the next year with a relatively weak economic and fiscal situation. A major fiscal stimulus was required to minimize the adverse impact of COVID in FY21. The combination of fiscal stimulus and a contraction in nominal GDP, resulted in the GoI's fiscal deficit to GDP ratio reaching 9.2%, its highest level at least since FY1991.[30]. It took concerted effort from then onwards to put GoI's fisc back on the path of fiscal responsibility in incremental steps. The FY25 interim budget projects FY26 fiscal deficit to GDP ratio at 4.5%. Considering incremental reductions of 0.5 percentage points each year, the GoI may reach the target level of fiscal deficit at 3% of GDP in another three years. Thus, it took only one year for the GoI's fiscal deficit to GDP ratio to slip to 9.2% while it would take eight years for the correction to be completed.

Chart 16.3: Fiscal deficit to GDP ratio (%)



Source (basic data): Union budget documents and MoSPI

[30] Historic data on GoI's fiscal deficit is available from FY1991 onwards from Indian Public Finance Statistics, MoF

Understanding the budget arithmetic

It is useful to understand the adjustments in the fiscal aggregates that enabled creation of adequate fiscal space for the reduction in the fiscal deficit. The first positive element that requires emphasis is the improvement in GoI's GTR which rose as percentage of GDP from a low of 11.2% in FY23 to 11.7% in FY25 (BE) as shown in **Table 16.4**. This provided additional fiscal space to the extent of 0.48 percentage points and 0.24 percentage points of GDP considering GoI's gross and net tax revenues in FY25 (BE) vis-à-vis FY23. The lower margin in the case of net tax revenues reflects increase in the share of states' in GoI's GTR which should lead to some improvement in revenue flows to the states if the budget estimates turn out to be correct. Most of this improvement has happened between FY23 and FY24 (RE). The second component of adjustment relates to reduction in revenue expenditures relative to GDP. This has fallen from 12.68% in FY23 to 11.94% in FY24 (RE) and further to 11.15% in FY25 (BE). Comparing FY23 to FY25 (BE), there were additional non-debt receipts to the extent of 0.39 percentage points of GDP and saving in revenue expenditures to the extent of 1.52 percentage points of GDP. This fiscal space amounting to 1.91 percentage points of GDP was utilized for two purposes namely (1) reduction in fiscal deficit to the extent of 1.24 percentage points and (2) increase in capital expenditures to the extent of 0.67 percentage points of GDP. This is why we can consider the FY25 budget as supporting growth while succeeding in achieving fiscal consolidation.

Table 16.4: Budget arithmetic: FY25 (BE)

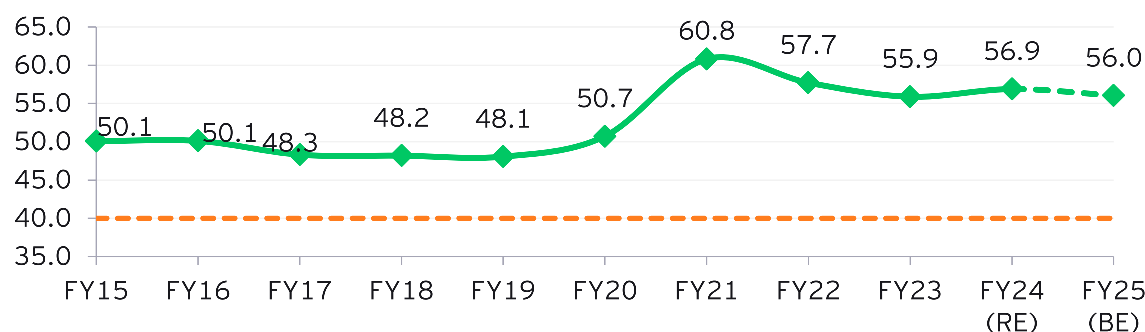
Item	FY22	FY23	FY24 (RE)	FY25 (BE)	FY25 (BE) minus FY23	FY23 over FY22	FY24 (RE) over FY23	FY25 (BE) over FY24 (RE)
	% to GDP				percentage points	% growth		
Gross tax revenues	11.54	11.21	11.59	11.69	0.48	12.7	12.5	11.5
Net tax revenues	7.69	7.70	7.84	7.94	0.24	16.2	10.8	11.9
Non-tax revenues	1.56	1.05	1.27	1.22	0.17	- 21.8	31.7	6.4
Non-debt capital receipts	0.17	0.27	0.19	0.24	-0.02	83.4	- 22.4	41.1
Non-debt receipts	9.41	9.01	9.29	9.40	0.39	11.1	12.2	11.8
Fiscal deficit	6.75	6.38	5.85	5.14	-1.24	--	---	--
Total expenditure (5+6)	16.16	15.39	15.14	14.54	-0.85	10.5	7.1	6.1
Revenue exp.	13.64	12.68	11.94	11.15	-1.52	7.9	2.5	3.2
Capital exp.	2.53	2.72	3.20	3.39	0.67	24.8	28.4	16.9
Memo	*INR lakh crore*					*% growth*		
Nominal GDP	234.7	272.4	296.6	327.7		16.1	8.9	10.5

Source (basic data): Union budget documents and MoSPI

Evolving debt-to-GDP profile

The improvement in fiscal deficit should also reflect in an improvement in the debt-GDP ratio of the GoI (Chart 16.4). The extent of this improvement however depends on the extent to which nominal GDP growth exceeds effective interest rate[31].

Chart 16.4: Trends in GoI's debt-GDP ratio



Source (basic data): Union budget documents and MoSPI (debt is evaluated at historic exchange rates)

The reduction in the debt-GDP ratio in FY25 (BE) is expected to continue if the nominal GDP growth improves in the subsequent years and fiscal and primary deficits continue to fall. As a result of falling debt-GDP ratio, we may expect a fall in the interest payments to revenue receipts, creating further space for reduction in revenue expenditures. It may be recalled that as far as the GoI is concerned, the sustainable level of debt relative to GDP as per the 2018 amendment to the FRBMA has been kept at 40% which is still some distance away. Simulations indicate that it may take up to the mid-2030s for this level to be reached if a 3% fiscal deficit to GDP ratio is maintained from FY28 onwards and a nominal GDP growth of 11.1% is also reached and sustained in subsequent years[32].

Conclusion: Fiscal consolidation and medium-term growth

In the presence of continuing global economic slowdown, India may have to rely largely on domestic growth drivers. In this context, GoI's strategy to proceed on the path of fiscal consolidation by relatively de-emphasizing revenue expenditures and creating fiscal space for augmenting capital expenditure aimed at supporting infrastructure growth is the most desirable strategy for sustained real GDP growth in the medium term. As GoI's debt and fiscal deficit to GDP ratios fall, there would be lower claim of the government on available investible surplus in the economy which should lead to interest rate reduction and therefore encourage private investment. Further, the share of interest payments in revenue expenditures would also fall over time with a fall in the debt-to-GDP ratio along with some fall in the effective interest rate on government debt. This would create further space for the government to continue increasing its infrastructure spending. Based on the IMF's January 2024 revision, India's growth is projected at 6.7%, 6.5% and 6.5% respectively for the three years covering FY24 to FY26[33]. Earlier, in their October 2023 issue of World Economic Outlook, they had projected a growth rate of 6.3% each for FY27 to FY29. Even these growth rates may be revised upwards subsequently if India continues with the current strategy combining capital expenditure expansion along with fiscal consolidation.

[31] Refer to the following equation $b_t - b_{t-1} = p_t - b_{t-1}[(g_t - i_t)/(1 + g_t)]$. This equation shows that current debt-GDP ratio would be lower than the debt-GDP ratio of the preceding year if the second term on the RHS is higher than the primary deficit of the current year. It can be shown that the second term on the RHS exceeds the first term by a margin of close to 0.9% points of GDP which is also the extent of reduction in the debt-GDP ratio of GoI from 56.9% in FY24 (RE) to 56% in FY25 (BE).

[32] See EY Economy Watch January 2024 issue for the simulation results.

[33] Earlier the October 2023 issue of IMF WEO had projected India's real GDP growth for FY24 to FY26 at 6.5%, 6.3% and 6.3% respectively.

Chapter 17

Budget 2024-25: Fiscal reforms: FY15 to Budget FY25 and beyond (July 2024)

Abstract

The final budget for FY25 continued to emphasize the GoI's capital expenditure growth as the primary vehicle for driving the overall GDP growth. This budget provided for 17.1% capital expenditure growth in FY25 over the CGA actuals. The budget continued to emphasize the importance of fiscal consolidation by providing for a reduction in the fiscal deficit to GDP ratio by 0.7% points from 5.6% in FY24 to 4.9% in FY25 (BE). It turned out that it was mainly due to the elections that the GoI could not achieve its budgeted capital expenditure growth. In fact, till November 2024, that is, for a period of eight months, GoI's capital expenditures showed only a contraction. It has started recovering since then. But the revised estimates for FY25 shows a growth of only 7.3% against a budgeted target of 17.1%. This slippage is one of the main reasons for the lowering of real GDP growth which is estimated at 6.4% as per the first advanced estimates for FY25.

Introduction

The final GoI FY25 budget signals the completion of a 10-year period of the current government and the beginning of another five-year term. It is an appropriate time to take account of the fiscal reforms undertaken so far and the direction in which the fiscal system and the economy would be moving forward in the medium-term. In this write-up, we will highlight major milestones and achievements over the last 10 years covering FY15 to FY24 and assess the fiscal and economic platform that has been built so far in order to take the Indian economy and government finances into the first five-year term of the Amrit Kaal.

Tax-GDP ratio: Inching upwards

India's combined tax-GDP ratio had languished in the range of 16% to 18% over a period of more than three decades from the late 1980s up to the recent years. There are indications that India may finally be breaking out of this ceiling of 18% of the combined tax-GDP ratio **(Table 17.1)**. During FY15 to FY24, there has been a rise of more than 2 percentage points in the combined tax-GDP ratio of the GoI and the states which had fallen to a trough of 16.1% during FY20 and FY21. FY20 was characterized by the adverse impact of two major tax reforms that occurred in quick succession relating to the introduction of GST in 2017 and extensive CIT reform in 2019. In FY21, the economy and the government finances were beset by the onset of COVID-19. The pick-up in the combined tax-GDP ratio in the last three years from FY22 to FY24 is expected to continue assuming that the global economy does not suffer another major shock. If a buoyancy of about 1.1 is maintained, we expect that the combined tax-GDP ratio would progressively increase to about 23.5% by FY48, an increase of 5 percentage points over a period of 24 years. The contribution of GoI's GTR in this would be 3.2 percentage points, the balance being made up by an increase in states' own tax revenue to GDP ratio. The underlying assumption is a sustained nominal GDP growth of 11% over this period.

Table 17.1: Combined and GoI's tax-GDP ratio (%)

Years	GoI's GTR (CGA)	Direct tax to GDP (CGA)	Indirect tax to GDP (CGA)	Combined tax-GDP
FY15	**10.0**	5.5	4.4	**16.4**
FY16	**10.6**	5.3	5.1	**16.9**
FY17	**11.1**	5.4	5.6	**17.1**
FY18	**11.2**	5.7	5.3	**17.8**
FY19	**11.0**	6.0	5.0	**17.4**
FY20	**10.0**	5.2	4.8	**16.1**
FY21	**10.2**	4.7	5.4	**16.1**
FY22	**11.5**	5.9	5.5	**17.7**
FY23	**11.3**	6.1	5.1	**18.0**
FY24	**11.7**	6.5	5.1	**18.5**

Source (basic data): Union Budgets, CGA, CAG, IPFS
Notes: (1) GoI's GTR includes direct, indirect and other taxes as provided by the CGA
(2) For estimating the combined tax revenues for FY24, data for states' own tax revenues is sourced from CAG

GoI's GTR to GDP ratio had increased from 10% in FY15 and again in FY20, to 11.7% in FY24. Over the period from FY20 to FY24, the increase in direct tax-GDP ratio was 1.3 percentage points and that in the indirect tax-GDP ratio was 0.3 percentage points. In fact, the indirect tax-GDP ratio had increased to a recent peak of 5.5% in FY22 from which it fell to 5.1% in FY23 and FY24 mainly because of a contraction in union excise duties and a subdued growth in customs duties. In line with

these trends, going forward, we expect a greater contribution of direct taxes in the overall tax-GDP ratio of the GoI.

Major tax reforms: GST and CIT

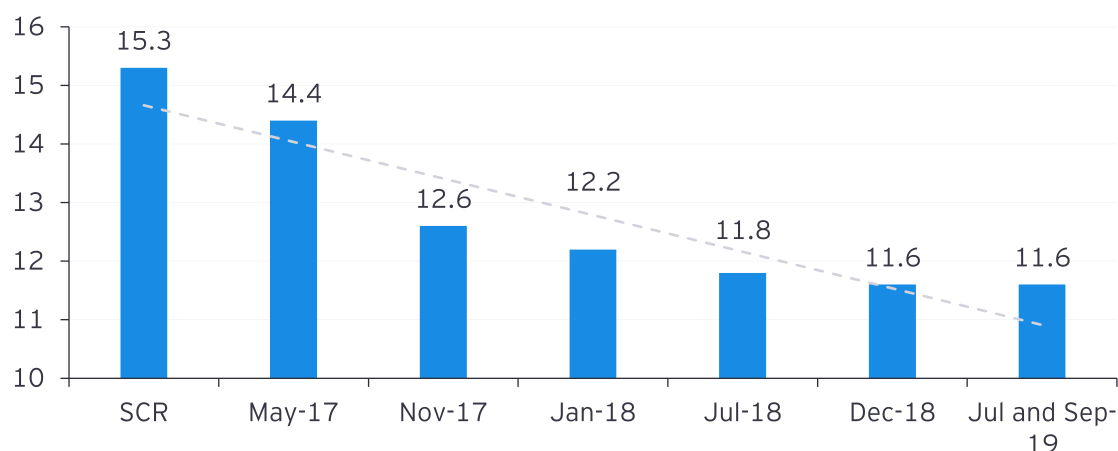
During the period FY15 to FY24, two major tax reforms were undertaken. These are briefly discussed below.

Goods and Services Tax (GST)

GST in India was introduced in July 2017 after a long period of dialogue between the GoI and state governments. Besides transitional issues, the GST rate structure did not amount to a revenue neutralizing effective rate. This was the main reason for the domestic indirect tax system in India showing lower growth and buoyancy in the initial years as compared to the pre-GST years. This situation started to improve FY22 onwards.

An RBI study (RBI Bulletin September 2019) estimated that the effective weighted average GST rate has fallen over time as compared to the effective revenue neutral rate (RNR) at the time of transition. The effective weighted average GST rate was estimated at 14.4% in May 2017, just prior to the introduction of GST in July 2017 (Chart 17.1). This had fallen to 11.6% in the period July to September 2019.

Chart 17.1: Weighted average (effective) GST rate (%)



Source (basic data): RBI Bulletin September 2019
Note: SCR refers to Subramanian Committee recommendation

The dynamics of deliberations of GST Council has been such that there is a clear emphasis on achieving unanimity amongst all participants. The states have tended to agree to relatively lower rates, especially in view of the provision for compensation for the first five years up to June 2022. The various compensation cesses would be continued for some more time to facilitate payment for unpaid accumulated arrears on account of due compensation. As the GST Council has not agreed to an extension of the compensation provision beyond five years, it may be possible progressively to reach a genuinely effective RNR in the near future. Going forward, as India's GST is made more comprehensive by including some of the sectors that are left out, care should be taken to ensure continued revenue neutrality when items presently excluded from the GST are brought into its ambit.

Corporate Income Tax (CIT)

The second major tax reform, implemented in September 2019, related to a reduction in the effective corporate income tax rate for specified categories. There was a reduction in the basic CIT rate applicable to domestic companies from 30% to 22% translating into a reduction of nearly 10 percentage points, including cesses and surcharges. For new investments in the manufacturing sector, the basic CIT rate was reduced from 25% to 15%, translating into a reduction of nearly 12

percentage points including cesses and surcharges. This benefit was available to companies which did not avail any exemption/incentive and commenced their production on or before 31 March 2023. This was later extended to 31 March 2024.[34] owing to the adverse impact of COVID-19. Further, in order to provide relief to companies which continued to avail exemptions/incentives, the rate of Minimum Alternate Tax (MAT) was reduced from 18.5% to 15%. These rate reductions were effective from FY20. While availing the option of reduced tax rates, the domestic companies had to forego all other exemptions or incentives. A comparable rate reduction was not provided for foreign companies operating in India.

The immediate impact of this was a fall in the CIT revenues of the GoI. CIT revenues showed a contraction of (-)16.1% in FY20 as compared to a growth of 16.2% in FY19. However, revenues have recently picked up. In FY22, FY23 and FY24, CIT revenues showed growth rates of 55.7%, 16.0% and 10.3% respectively with buoyancies at 3.0 in FY22, and 1.1 each in FY23 and FY24.

Non-tax revenue (NTR) reforms: Asset monetization

The contribution of NTR to overall revenue receipts for the combined account of GoI and state governments as well as for the GoI's revenue receipts has been rather limited. In the case of the combined NTR, this contribution, measured as a percentage of GDP has ranged between 1.9% to 2.8% over the period FY15 to FY24 (Table 17.2). In GoI's case, this has ranged from 1.05% to 1.82%.

Table 17.2: Trends in combined and GoI's non-tax revenues (NTR) (% to GDP)

Year	GoI's NTR of which:	*Interest receipts*	*Dividends and profits*	*Other NTR*	Combined NTR
FY15	**1.59**	0.19	0.72	0.67	2.3
FY16	**1.82**	0.18	0.81	0.83	2.8
FY17	**1.78**	0.11	0.80	0.88	2.8
FY18	**1.10**	0.08	0.53	0.49	2.1
FY19	**1.25**	0.07	0.60	0.58	2.3
FY20	**1.62**	0.06	0.92	0.58	2.8
FY21	**1.05**	0.09	0.49	0.47	1.9
FY22	**1.55**	0.09	0.68	0.77	2.5
FY23	**1.06**	0.10	0.37	0.59	2.1
ssFY24	**1.36**	0.13	0.58	0.65	2.3*

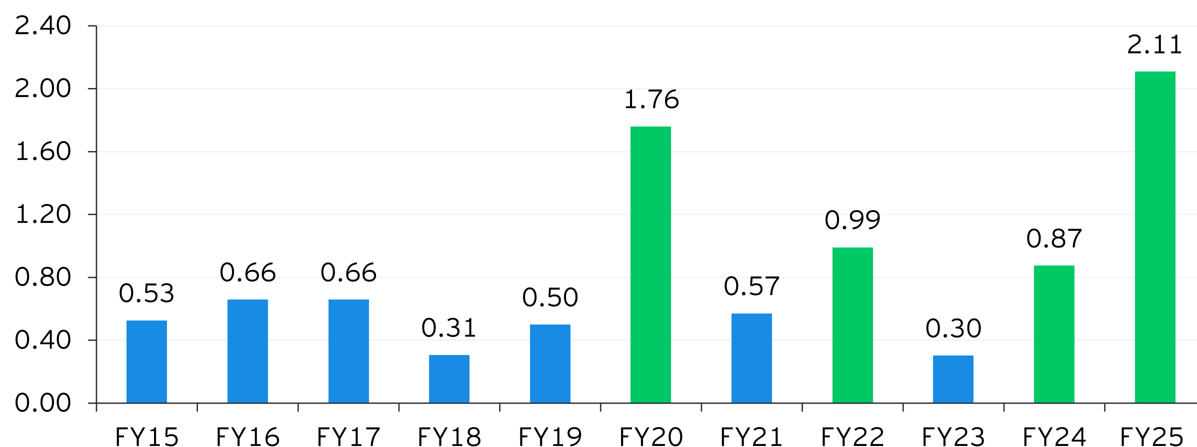
Source (basic data): CGA, MoSPI, and IPFS

*GoI's non-tax revenues have been sourced from the CGA and it excludes externally aided grants received by the GoI but transferred to the states and interest receipts from the states. Data for externally aided grants received by the GoI but transferred to the states and interest receipts from the states pertain to revised estimates. States' non-tax revenues are sourced from the CAG.

One important component of GoI's NTR is dividends and profits, which include RBI's dividends. From time to time, RBI's dividends have shown periodic jumps (Chart 17.2). It can be seen that the GoI could access relatively high magnitudes in FY20, FY22, FY24 and FY25. It may be noted that any transfer from the RBI to the GoI has monetary implications. Such transfers are, by nature, expansionary and may have an inflationary impact.

[34] https://rb.gy/gflehv

Chart 17.2: RBI's dividends (INR crore) to the GoI: FY15 to FY25



Source (basic data): RBI

Given the low level of contribution of NTR to the overall revenue receipts, the GoI had initiated certain revenue augmenting measures relating to NTR. In this context, an important initiative introduced in the FY22 Union Budget relates to the idea of monetization of government and public sector owned assets, including defense assets. A National Monetization Pipeline (NMP) was proposed as a first step towards assessing the potential value of government-owned assets and devising strategies for their monetization. Monetized government assets, if leased or rented out, may yield a stream of periodic incomes which may be counted under NTR. However, outright sale of assets would generate one-time receipts and may be considered as part of government's non-debt capital receipts.

Pursuant to the announcement in FY22, the NITI Aayog in collaboration with the concerned infrastructure ministries, prepared a list of potential core assets of the central government ministries/public sector enterprises (PSEs) for monetization during the period FY22 to FY25. The NMP included assets with monetization potential of INR6 lakh crore during the four-year period.

Table 17.3: Asset monetization in FY24: Top performing ministries

#	Ministry	Amount garnered (INR crore)	Share in total (%)
1	Road Transport and Highways	40,314	22.4
2	Ministry of Coal	56,794	31.6
3	Power	14,690	8.2
4	Petroleum and Natural Gas	9,587	5.3
5	Shipping	7,627	4.2
6	Urban	6,480	3.6
7	Mines	4,090	2.3
8	Others	40,418	22.4
	TOTAL	1,80,000	100.0

Source (basic data): PIB; https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2026675
For FY25, the NHAI has already identified and published an indicative list of 33 assets to be monetized.

The combined target for the first two years, namely FY22 and FY23, was around INR2.5 lakh crore, against which around INR2.30 lakh crore was achieved. During FY24, against the target of INR1.8 lakh crore, which is the highest amongst all the four years, the achievement has been around INR1.56 lakh crore. The achievement rates were about 92% in FY22 and FY23 considered together, and 87% in FY24.The top performing ministries with respect to asset monetization in FY24 are given in Table 17.3. It is seen that seven ministries accounted for 77.5% of the total target for FY24.

Expenditure side reforms: Prioritization of capital expenditure

Size of government

The size of government in terms of the ratio of total expenditure to GDP or primary expenditure to GDP indicates the purchase of goods and services by the government sector in the economy. At the level of combined government expenditures, total expenditure relative to GDP is in the range of 25.52% (FY15) to 30.47% (FY21) (Table 17.4). For the GoI, total expenditure relative to GDP has ranged from 10.21% (FY19) to 14.09% (FY21). The level of 14.09%, is, however, not representative in the sense that this occurred in the COVID-affected year, which was characterized by a contraction in nominal GDP. In this year, it indicated that the fall in government expenditure tends to be limited as compared to the fall in GDP when the economy suffers a major shock. In a more representative way, we can consider the improvement in the level of GoI's expenditure as rising from 10.21% of GDP in FY19 to 13.01% in FY23. It is also notable that GoI's interest payments relative to GDP have increased due to higher debt incurred during the COVID year as a result of which the increase in GoI's primary expenditure relative to GDP at 2.2 percentage points is less than that in total expenditure relative to GDP at 2.7 percentage points during FY19 to FY24.

Table 17.4: Size of government (relative to GDP)

Year	Total expenditure			Primary expenditure		
	GoI	States	Combined [1]	GoI [2]	States[3]	Combined
FY15	10.51	15.00	25.52	7.35	13.47	20.82
FY16	10.91	16.54	27.45	7.76	14.96	22.72
FY17	10.94	16.82	27.76	7.87	15.19	23.06
FY18	10.30	15.91	26.21	7.25	14.19	21.44
FY19	10.21	16.24	26.45	7.17	14.55	21.72
FY20	10.71	15.86	26.57	7.70	14.13	21.83
FY21	14.09	16.38	30.47	10.70	14.65	25.35
FY22	12.71	16.51	29.22	9.33	14.70	24.02
FY23	13.01	15.54	28.54	9.60	13.78	23.38
FY24	12.92	14.60	27.52	9.36	12.84	22.20

Source (basic data): Union Budget documents, CGA, CAG
Notes:
(1) Net of intergovernmental flows. For deriving combined total expenditure, the following adjustments were made to GoI and States' revenue and capital expenditure
a. GoI's revenue expenditures exclude transfer of total grants from GoI to states and UTs
b. States' revenue expenditures exclude interest payment by states to GoI
c. GoI's capital expenditure excludes net loans and advances to states (where Net loans and advances to states = gross loans from GoI to states and UTs less repayment of loans and advances by states and UTs)
(2) GoI's primary expenditure = GoI's total expenditure less GoI's interest payments (where GoI's interest payment excludes interest receipts from states on loans given by GoI)
(3) For FY24, interest payments for states have been taken as per BE sourced from RBI.

Abolition of plan-non plan distinction in expenditures

In 2011, an Experts' Group headed by C. Rangarajan had proposed the abolition of the distinction between plan and non-plan expenditure for the GoI and the states.[35]. A number of recent Finance Commissions (FCs) had also recommended abolition of this distinction, as it led to various inefficiencies. Plan expenditure was generally considered as additional developmental expenditure and given undue priority over essential maintenance expenditures, which were categorized as non-plan non-developmental expenditures. There was an undue emphasis on creation of new assets rather than maintenance of old assets. The plan-non plan distinction largely affected the expenditure side, but it also had a revenue side counterpart in the sense that some of the transfers to the state governments were recommended by the erstwhile Planning Commission as Plan grants. With the abolition of plan non-plan distinction, there was a merger of a large part of plan grants in the regular fiscal transfers under the recommendations of the Fourteenth FC.

Rationalization of centrally sponsored schemes (CSS)

After the discontinuation of the plan process in FY15, it was felt that CSS also need to be rationalized. A 'Sub-Group of Chief Ministers' was constituted in March 2015 for restructuring and rationalizing CSS and suggesting suitable measures for ensuring that their implementation is streamlined and adequately flexible. The recommendations of this Committee were implemented in FY16.

The Committee had identified ten priority sectors that would form a part of the 'National Development Agenda' and it was recommended that the GoI and state/UT governments should focus on achieving objectives of the CSS in these areas. These areas are listed below:

1. **Poverty elimination:** livelihoods, jobs, and skill development
2. **Drinking water and Swachh Bharat Mission**
3. **Rural connectivity:** electricity, access roads, and communication.
4. **Agriculture:** including animal husbandry, fisheries, integrated watershed management and irrigation
5. **Education:** including mid-day meals
6. **Health:** including nutrition, women and children
7. **Housing for all:** rural and urban
8. **Urban transformation**
9. **Law and order**: including justice delivery systems
10. **Others:** including wildlife conservation and greening

About 66 schemes which were operational at that time were rationalized into 28 umbrella schemes. Of these, six were categorized as 'core of the core schemes', 20 as core schemes, and the remaining two as optional schemes. Core schemes required compulsory participation by states/UTs, while participation in optional schemes was by choice. If required, related schemes could be merged and implemented as 'Umbrella schemes' with flexibility to states/UTs to administer the admissible components in line with state/UT specific requirements.

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[35]https://www.business-standard.com/article/economy-policy/framework-for-abolition-of-plan-non-plan-classification-soon-116051801518_1.html

Structural shift towards capital expenditure

A major dimension of fiscal reforms during the last 10 years pertains to a tangible increase in the share of capital expenditure in total expenditure of the GoI. This share has increased from 11.8% in FY15 to 21.4% in FY24, an increase of 9.6 percentage points (Table 17.5). Most of this increase has occurred during FY22 to FY24. Within capital outlay, there is a further trend of an increase favoring non-defense expenditure, which implies expenditure on infrastructure. The share of non-defense outlay in total expenditure rose from 5.2% in FY21 to 11.5% in FY23. It is this structural shift that became instrumental for GoI's policy emphasis on infrastructure expansion, which has had a positive impact on growth. Correspondingly, there has been a fall in the share of revenue expenditure in total expenditure.

Table 17.5: Structure of GoI's total expenditure (share in total expenditure in %)

Item	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24 (CGA)
Revenue exp.	**88.2**	**85.9**	**85.6**	**87.7**	**86.7**	**87.5**	**87.9**	**84.4**	**82.4**	**78.6**
Interest	24.2	24.7	24.3	24.7	25.2	22.6	19.1	21.1	22.1	23.9
Defense	8.2	8.1	8.4	8.7	8.4	7.7	5.9	6.0	6.1	NA
Capital exp.	**11.8**	**14.1**	**14.4**	**12.3**	**13.3**	**12.5**	**12.1**	**15.6**	**17.6**	**21.4**
Capital outlay	10.1	12.7	12.5	11.4	12.1	11.6	9.0	14.1	14.9	NA
Non-defense	5.1	8.2	8.2	7.2	8.0	7.5	5.2	10.5	11.5	NA
Defense	4.9	4.5	4.4	4.2	4.1	4.1	3.8	3.6	3.4	NA

Source (basic data): Union budget documents, MoSPI, and CGA

Two major items under revenue expenditure are interest payments and defense expenditures. Interest payments account for nearly one-fourth of GoI's total expenditures. In the case of defense expenditure, there has been a fall in its share in total expenditure from a level of 8.2% in FY15 to 6.1% in FY23.

Merger of railway budget with the main budget

With effect from FY18, the rail budget was merged with the Union Budget. Railways continued to function as a departmentally run commercial undertaking. However, a separate statement of budget estimates and demand for grants was created for railways. It is the Ministry of Finance (MoF) that started to handle all legislative work connected with the railways. After this merger, railways got exemption from payment of dividend to general revenues. The MoF provided gross budgetary support to the Ministry of Railways towards meeting its capital expenditure, while the Ministry of Railways was also given the freedom to raise resources from the market for financing its capital expenditure. It was expected that the merger of the rail budget with the Union Budget would facilitate multimodal transport planning between highways, railways, and inland waterways[36].

Advancement of Budget presentation

With effect from the FY18 budget, the date of presentation of the Union Budget was advanced by nearly one month as compared to its regular date of end-February. This was meant to enable the government to launch its capital expenditures from the beginning of the financial year itself, that is,

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[36] Merger of Rail Budget With Union Budget (pib.gov.issn)

in the month of April. This allowed a number of infrastructure projects to be undertaken before the onset of the monsoons. In earlier years, major infrastructure projects were often launched only in September, after the end of the rainy season.

Subsidy reduction and transition to direct benefit transfer (DBT)

An important component of revenue expenditures are subsidies that are explicitly provided in the budget. Major GoI subsidies relate to food, fertilizer, and petroleum. As a part of prioritized reform, the GoI had focused on reducing the share of major subsidies in government revenue expenditures. The GoI was able to achieve a steady reduction in major subsidies which were at its peak relative to GDP at 3.57% in the COVID year of FY21 (Table 17.6). Since then, this ratio has fallen to 1.40% in FY24.

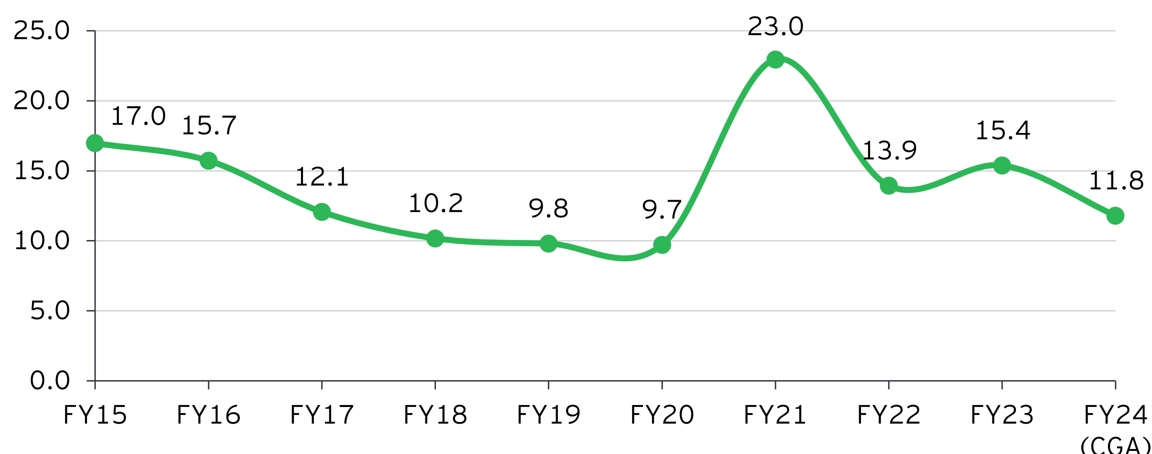
Table 17.6: Trends in major subsidies (% of GDP)

Year	Major subsidies of which	Fertilizer subsidy	Food subsidy	Petroleum subsidy
FY15	2.00	0.57	0.94	0.48
FY16	1.76	0.53	1.01	0.22
FY17	1.33	0.43	0.72	0.18
FY18	1.12	0.39	0.59	0.14
FY19	1.04	0.37	0.54	0.13
FY20	1.14	0.40	0.54	0.19
FY21	3.57	0.65	2.73	0.19
FY22	1.90	0.66	1.23	0.01
FY23	1.95	0.92	1.00	0.03
FY24 (CGA)	1.40	0.64	0.72	0.04

Source (basic data): Union budget documents, MoSPI, and CGA

The period from FY15 to FY20 witnessed a steady reform aimed at reducing the share of subsidies in GoI's revenue expenditure primarily by better targeting and delivery to the intended beneficiaries through DBT by using India's substantially improved public digital infrastructure. As a result, as a percentage of revenue expenditures, major subsidies fell from 17% in FY15 to 9.7% in FY20 (Chart 17.3). This was disturbed in the COVID year, where there was a dire need to increase the extent of benefits and the ambit of beneficiaries. In that year, the share of major subsidies in GoI's revenue expenditure shot up to 23%. This includes the effect also of GoI's effort towards transparency by clearing any arrears of entities like Food Corporation of India (FCI) and the Oil Marketing Companies. However, since then, it has progressively been brought down to 11.8% in FY24.

Chart 17.3: Share of major subsidies in GoI's revenue expenditure (%)



Source (basic data): Union budget documents, MoSPI, and CGA

Direct benefit transfers

As part of overall fiscal reforms, the GoI focused on the strategy of DBT, taking advantage of the evolving IT and digital platforms with a view to minimizing leakages and improving transparency and timeliness of delivery of benefits to the intended beneficiaries. The Jan Dhan accounts played a major role in the success of the DBT strategy. The GoI utilized both cash transfers and transfers in kind as delivery methods for benefit transfers. **Table 17.7** gives the progress of DBT in terms of the growing magnitudes of the cash and in-kind transfers, as well as the number of beneficiaries. The amount of total funds transferred under DBT witnessed a near-18 fold increase from INR38,926 crore in FY15 to INR6,91,360 crore in FY24.

Table 17.7: Amount of funds transferred and number of beneficiaries under DBT

Year	Amount of funds transferred under DBT (INR crore)			Number of beneficiaries under DBT (crore)	
	Cash	In Kind	Total	Cash	In Kind
FY15	38,926	-	**38,926**	22.8	0
FY16	61,942	-	**61,942**	31.2	0
FY17	74,689	-	**74,689**	35.7	0
FY18	1,70,292	20,579	**1,90,871**	46.3	77.7
FY19	2,14,092	1,15,704	**3,29,796**	59	70.2
FY20	2,39,729	1,41,902	**3,81,632**	70.6	74.1
FY21	2,96,578	2,55,950	**5,52,527**	98	81.9
FY22	2,68,139	3,62,126	**6,30,265**	73.5	105.4
FY23	2,60,573	4,55,823	**7,16,396**	72.3	93.7
FY24	2,92,444	3,98,916	**6,91,360**	71.2	104.8

Source (basic data): https://dbtbharat.gov.in/

Budget transparency

In recent years, the GoI has undertaken certain initiatives in the direction of increasing the transparency of the budgetary process, especially by minimizing off-budget entries. Some major steps in this context are as follows:

1. Starting FY20, the Union Budget began publishing a statement of extra budgetary resources (EBR) employed by the CPSEs.
2. Until recently, the union government was using the FCI to borrow from the NSSF in lieu of the due payment of food subsidy, with this amount not forming a part of GoI's fiscal deficit. This practice was discontinued FY21 onwards with the GoI bringing this amount onto its books.

Restoring fiscal consolidation: FRBM amendment and beyond

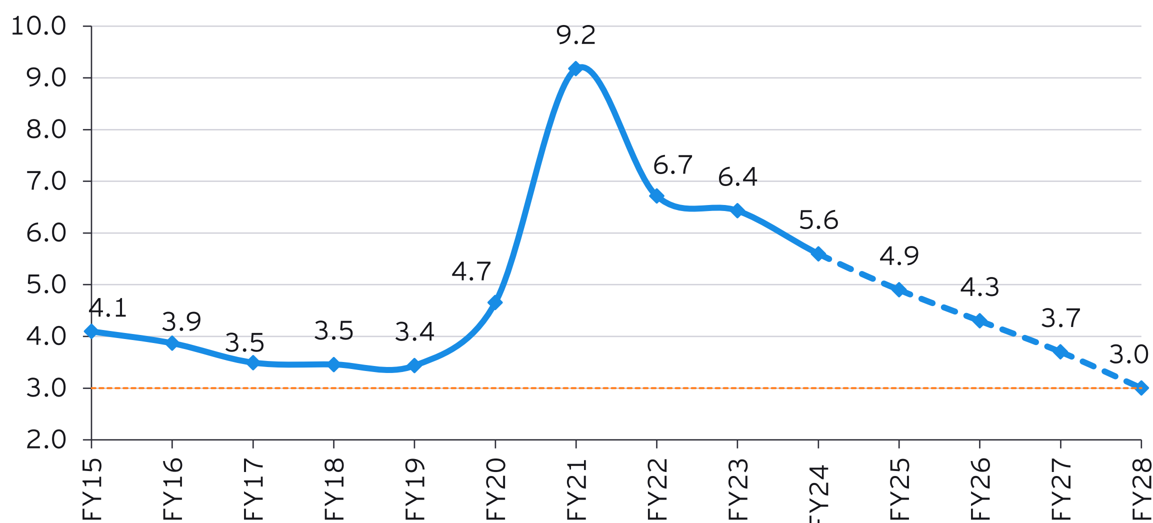
A major landmark during the period under review was the amendment in 2018 of the GoI's Fiscal Responsibility and Budget Management Act (FRBMA) of 2003. Some of the key features of this amendment are summarized below:

1. The fiscal deficit to GDP ratios for the central and state governments were retained at 3% each.
2. The target of achieving a balance on the revenue account was given up.
3. The debt-GDP targets were specified for the consolidated account of central and state governments at 60%, that for the central government at 40%, and by implication, that for the state governments at 20%.[37].
4. Some departure from the annual fiscal deficit norms was permitted under certain conditions with a view to providing a macro stabilizing role to the GoI.

Chart 17.4 shows the evolution of GoI's fiscal deficit to GDP ratio during FY15 to FY24 and beyond. At first, the GoI made a conscious effort to incrementally reduce the fiscal deficit to GDP ratio from 4.1% in FY15 to 3.4% in FY19. However, due to the adverse revenue effect of the tax reforms pertaining to the GST and the CIT, an upward movement in the fiscal deficit to GDP ratio to 4.7% was seen in FY20. This deteriorated further to 9.2% in the COVID year of FY21. Since then, there has been a steady improvement in the fiscal deficit to GDP ratio, which is slated to fall to 4.9% by FY25. We expect that this can be taken to 3% in the next three years, assuming an annual reduction of about 6 percentage points.

[37] It can be shown that an asymmetric set of targets for the debt-GDP ratio is inconsistent with symmetric targets for the fiscal deficit to GDP ratio between the GoI and the aggregate of state governments (See, Srivastava, D.K., Bharadwaj, M., Kapur, T., & Trehan, R. (2021). Covid's Economic Impact: Should India Recast its Fiscal and Monetary Policy Frameworks?: Journal of International Economics and Finance. 1(1), 63-81)

Chart 17.4: GoI's fiscal deficit to GDP ratio (%)



Source (basic data): Union budget documents and MoSPI

The quality of fiscal deficit, as measured by the ratio of revenue deficit to fiscal deficit, has also improved. The higher is the value of this ratio, the larger is the proportion of total borrowing used for non-asset forming expenditure. This was as high as 76% in FY18 and 79.8% in FY21 (Table 17.8). Since then, it has fallen to 46.3% in FY24, indicating larger use of borrowed resources to finance asset-forming expenditures such as those on infrastructure expansion, thereby supporting growth. Correspondingly, in FY24, the share of capital expenditure in fiscal deficit has increased to 57.4%.

Table 17.8: GoI's deficit and debt Indicators (% to GDP)

Fiscal year	Revenue deficit	Fiscal deficit	Primary deficit	Debt$	RD/FD ratio	CE/FD ratio
FY15	2.93	4.10	0.87	50.1	71.6	38.5
FY16	2.49	3.87	0.66	50.1	64.3	47.5
FY17	2.06	3.49	0.37	48.3	58.9	53.2
FY18	2.63	3.46	0.36	48.2	76.0	44.4
FY19	2.41	3.44	0.35	48.1	70.1	47.3
FY20	3.32	4.65	1.61	50.7	71.3	36.0
FY21	7.32	9.17	5.74	60.7	79.8	23.3
FY22	4.37	6.71	3.31	57.4	65.1	37.4
FY23	3.97	6.43	2.99	56.5	61.7	42.5
FY24	2.59	5.60	2.00	57.14*	46.3	57.4

Source (basic data): Union budget documents, CGA and MoSPI
$ Sourced from Union Budget documents
*Estimated by addition of annual fiscal deficit for FY24 to the liabilities at the end of FY23 as taken from the Union Budget
RD = Revenue deficit, FD = Fiscal Deficit and CE= Capital expenditure

The improvement in fiscal deficit is also reflected in an improvement in the debt-GDP ratio of the GoI, which fell from a peak of 60.7% in the COVID year of FY21 to 57.1% in FY24. The reduction in the debt-GDP ratio in FY25 (BE) and beyond is expected to continue if the nominal GDP growth exceeds 11% which was the underlying growth assumption in the calculation of the sustainable level of debt-GDP ratio in the FRBM 2018 amendment[38]. As a result of falling debt-GDP ratio, we may expect a fall in the interest payments to revenue receipts, creating further space for reduction in revenue expenditures. The fall in interest rates due to lower government borrowing may also stimulate private investment in the economy.

Union Budget FY25: laying foundation for medium-term growth

GoI's final FY25 budget has assumed an underlying nominal GDP growth of 10.5%, same as that assumed in the Interim Budget (Table 17.9). The Economic Survey of FY24, which was released a day before the presentation of the Budget, had indicated a real GDP growth in the range of 6.5% to 7.0%. Taking its mid-point at 6.75%, a nominal GDP growth of 10.5% implies an implicit price deflator (IPD)-based inflation 3.5% in FY25. This appears realistic as WPI inflation which has a higher weight in the construction of the IPD, is expected to reach back to its normal levels after being inordinately low at (-)0.7% in FY24. The Budget has assumed a buoyancy of GoI's GTR at 1.03 in FY25. This would result in a growth of 10.8% in GoI's GTR with the corresponding magnitude at INR38.4 lakh crore (Table 17.9) as compared to INR38.3 lakh crore in the Interim Budget. Despite the GTR being marginally higher due to higher budgeted tax devolution to the states as compared to the Interim Budget, the net tax revenue in final Union Budget 2024-25 at INR25.8 lakh crore is lower than that in the interim budget by INR18,000 crore. By adding to GoI's net tax revenues, non-tax revenues of INR5.46 lakh crore budgeted to be realized primarily on account of significantly enhanced RBI dividend, the resultant GoI's revenue receipts amount to INR31.29 lakh crore. To this, if we add non-debt capital receipts of INR78,000 crore, we get non-debt receipts amounting to INR32.07 lakh crore.

Table 17.9: Fiscal arithmetic

#	Item	FY24#	FY25 (BE)	FY23	FY24#	FY25 (BE)	FY24 over FY23	FY25 (BE) over FY24 (CGA Act.)
		INR lakh crore		% to GDP			% growth	
1	**Gross tax revenues**	***34.6***	***38.4***	**11.3**	**11.7**	**11.8**	**13.4**	**10.8**
2	Assignment to states	*11.3*	*12.5*	3.5	3.8	**3.8**	19.1	10.4
3	Net tax revenues	*23.3*	*25.8*	7.8	7.9	**7.9**	10.9	11.0
4	Non-tax revenues	*4.0*	*5.5*	1.1	1.4	**1.7**	40.8	35.8
5=3+4	**Revenue receipts**	***27.3***	***31.3***	**8.8**	**9.2**	**9.6**	**14.5**	**14.7**
6	Non-debt capital receipts	*0.6*	*0.8*	0.27	0.2	**0.2**	-16.3	29.0

[38] https://dea.gov.in/sites/default/files/Volume%201%20FRBM%20Review%20Committee%20Report.pdf (Page 54)

#	Item	FY24#	FY25 (BE)	FY23	FY24#	FY25 (BE)	FY24 over FY23	FY25 (BE) over FY24 (CGA Act.)
		INR lakh crore		% to GDP			% growth	
7=5+6	Non-debt receipts	*27.9*	*32.1*	9.1	9.4	**9.8**	13.6	15.0
8	**Fiscal deficit**	***16.5***	***16.1***	**6.4**	**5.6**	**4.9**	--	--
9=10+11	**Total expenditure**	***44.4***	***48.2***	**15.5**	**15.0**	**14.8**	**5.9**	**8.5**
10	Revenue exp.	*34.9*	*37.1*	12.8	11.8	**11.4**	1.2	6.2
11	Capital exp.	*9.5*	*11.1*	2.7	3.2	**3.4**	28.2	17.1
12=10-5	**Revenue deficit**	*7.7*	*5.8*	4.0	2.6	**1.8**	--	
13	**Debt**	***171.9****	***181.7***	56.5	**58.2***	**55.7**	--	
Memo				*INR lakh crore*			*% growth*	
14	**Nominal GDP**			**269.5**	**295.4**	**326.4**	**9.6**	**10.5**

Source (basic data): Union Budget documents, CGA
* Debt for FY24 in INR terms has been derived by using the provisional actual debt-GDP ratio of 58.2% and the magnitude of nominal GDP as per the union budget
# FY24 fiscal magnitudes are sourced from CGA (provisional actuals in the union budget)

One key feature of the Union Budget 2024-25 is its emphasis on accelerating the pace of fiscal consolidation. Accordingly, a fiscal deficit of 4.9% of GDP amounting to INR16.13 lakh crore has been budgeted. Thus, total expenditure is determined by the sum of non-debt receipts and fiscal deficit, which is equal to INR48.2 lakh crore. This is divided into revenue and capital expenditures in the ratio of 77:23. While capital expenditure has been maintained at its interim budget level of INR11.11 lakh crore, growth of revenue expenditure has been marginally increased to 6.2%. As compared to the interim budget, total additional resources at hand amounted to INR1.27 lakh crore. This was utilized to reduce fiscal deficit by a margin of INR72,182 crore as compared to its Interim Budget level, while revenue expenditure has been increased by INR54,744 crore.

Thrust towards fiscal consolidation

As the Budget has prioritized reduction in fiscal deficit over expanding either revenue or capital expenditures, it is useful to chart the progress made in reducing fiscal deficit from its peak of 9.2% of GDP in the COVID year to close to 3% of GDP as per the GoI's FRBM Act. This is shown in **Chart 17.4**. It may be noted that in FY25, government borrowings, both in gross and net terms, would be of a lower magnitude as compared to what was implied in the Interim Budget. With lower market borrowings, it is expected that room will be created for lowering interest rates. Thus, there is an attempt now to bring on board the private sector in order to stimulate growth in spite of the continuing global headwinds.

Employment initiatives

There has been a call for developing a counterpart to the existing production linked incentives (PLI). The FY25 final budget has now taken the first steps towards developing an employment-linked incentive (ELI) scheme. This scheme has three parts namely, (1) first timers joining a formal workforce, (2) job creation in manufacturing related to first time employees, and (3) an employer-

centric scheme covering all additional employment in all sectors within a salary of INR1 lakh per month. Additional incentives are being provided to facilitate higher participation by women in the workforce. The budget has also co-opted the private sector in the growth and employment augmentation initiatives by providing internship opportunities partially funded by the GoI and partially by the companies through their CSR funds. These incentives will supplement the employment generation linked to GoI's large capital expenditure. As per RBI's KLEMS database, there has been an acceleration of absorption of working age persons in agriculture as well as non-farm sectors mainly construction and trade from FY18 onwards, rising from 47.5 crore persons to 59.7 crore persons in FY23. The GoI has emphasized an employment strategy that promotes shifting workers from agricultural to non-agricultural sectors and from informal to formal sectors. This would help promote formalization and digitalization of the economy.

An important consideration relates to government's capacity both at the central and state levels to undertake investment expenditures successfully and effectively, at least up to the extent of budgeted amounts. In GoI's case, there was an underspending compared to the budgeted amounts both in FY23 and FY24. In FY24 and FY25, the GoI extended a long-term interest free loan facility to states amounting to INR1.3 lakh crore and INR1.5 lakh crore. The offtake of these amounts by the states was partial in FY24 and this trend may continue in FY25 since the amounts would be available for spending only in the post-monsoon months. Thus, there are indications that the investment led growth strategy appears to be decelerating.

Conclusion

Building on the extensive fiscal reforms during the last 10 years, the GoI has laid the foundations for a medium-term growth strategy with the final FY25 Budget. Fiscal reforms during FY15 to FY24 included: (1) amendment to the GoI's Fiscal Responsibility and Budget Management Act (FRBMA) in 2018, (2) implementation of GST, (3) extensive CIT reforms, (4) a steady reduction in subsidies relative to GDP and (5) implementation of schemes, such as DBT. With an investment led growth strategy and a trajectory of reduction in interest payments along with achievement of FRBM consistent level of fiscal deficit of 3% in the next three years and consequent reduction in GoI's debt-GDP ratio, a medium-term growth of 7% plus appears feasible. Care must be taken to ensure that this growth becomes progressively greener and employment oriented.

List of abbreviations

Sr. no.	Abbreviations	Description
1	AD	aggregate demand
2	AEs	advanced economies
3	Agr.	agriculture, forests and fishing
4	AY	assessment year
5	Bcm	billion cubic meters
6	bbl.	barrel
7	BE	budget estimate
8	CAB	current account balance
9	CGA	Comptroller General of Accounts
10	CGST	Central Goods and Services Tax
11	CIT	corporate income tax
12	Cons.	construction
13	CPI	Consumer Price Index
14	COVID-19	Coronavirus disease 2019
15	CPSE	central public-sector enterprise
16	CRAR	Credit to Risk- weighted Assets Ratio
17	Disc.	discrepancies
18	ECBs	external commercial borrowings
19	Elec.	electricity, gas, water supply and other utility services
20	EMDEs	Emerging Market and Developing Economies
21	EXP	exports
22	FAE	first advance estimates
23	FC	Finance Commission
24	FII	foreign investment inflows
25	Fin.	financial, real estate and professional services
26	FPI	foreign portfolio investment

Sr. no.	Abbreviations	Description
27	FRBMA	Fiscal Responsibility and Budget Management Act
28	FRL	Fiscal Responsibility Legislation
29	FY	fiscal year (April–March)
30	GDP	Gross Domestic Product
31	GFCE	government final consumption expenditure
32	GFCF	gross fixed capital formation
33	GoI	Government of India
34	G-secs	government securities
35	GST	Goods and Services Tax
36	GVA	gross value added
37	IAD	Index of Aggregate Demand
38	IBE	interim budget estimates
39	ICRIER	Indian Council for Research on International Economic Relations
40	IEA	International Energy Agency
41	IGST	Integrated Goods and Services Tax
42	IIP	Index of Industrial Production
43	IMF	International Monetary Fund
44	IMI	Index of Macro Imbalance
45	IMP	imports
46	INR	Indian Rupee
47	IPD	implicit price deflator
48	MCLR	marginal cost of funds-based lending rate
49	Mfg.	manufacturing
50	MGNREGA	Mahatma Gandhi National Rural Employment Guarantee Act
51	Ming.	mining and quarrying
52	m-o-m	month-on-month
53	Mt	metric ton
54	MoSPI	Ministry of Statistics and Programme Implementation
55	MPC	Monetary Policy Committee
56	MPF	Monetary Policy Framework

Sr. no.	Abbreviations	Description
57	NEXP	net exports (exports minus imports of goods and services)
58	NSO	National Statistical Office
59	NPA	non-performing assets
60	OECD	Organization for Economic Co-operation and Development
61	OPEC	Organization of the Petroleum Exporting Countries
62	PFCE	private final consumption expenditure
63	PIT	personal income tax
64	PMI	Purchasing Managers' Index (reference value = 50)
65	PoL	petroleum oil and lubricants
66	PPP	Purchasing power parity
67	PSBR	public sector borrowing requirement
68	PSU/PSE	public sector undertaking/public sector enterprises
69	RE	revised estimates
70	RBI	Reserve Bank of India
71	SLR	Statutory Liquidity Ratio
72	Trans.	trade, hotels, transport, communication and services related to broadcasting
73	US$	US Dollar
74	UTGST	Union Territory Goods and Services Tax
75	WALR	weighted average lending rate
76	WHO	World Health Organization
77	WPI	Wholesale Price Index
78	y-o-y	year-on-year
79	1HFY20	first half of fiscal year 2019-20, i.e., April 2019-September 2019

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