Fiscal Policy Challenges in India Post-Covid

By

N R Bhanumurthy

Vice Chancellor, Dr BR Ambedkar School of Economics University, Bengaluru,

E-mail: nrbmurthy@gmail.com ; views are personal

Introduction

- Indian economy estimated to grow at 7.3% in 2023-24 – recovery from Covid-19 and appears to be even…
- ….with predictions of about 7% growth in 2024-25…continue to be fastest growing large economy….and ‘bright spot in the troubled global economy’
- Inflation stays within RBI’s comfort level (for December 2023 at 5.69%)
- Forex reserves at 616 billions, with CAD at 1%
- There are some positive signs (IIP growth, credit off-take, …)
- Most importantly there is better co-ordination between fiscal and monetary policies
- Fiscal situation (especially at the States) continue to deteriorate
- Both Union and States invoked escape clause in the FRBM Act for two consecutive years …
- …Fiscal deficit for the Union in FY24 estimated at 5.8% and 5.1% for FY25….(general government deficit is still close to 9%)
- Improvement in quality of expenditures …RD as a share of FD sharply declined from 61.5% to 38.7% - suggests expansionary fiscal consolidation

Introduction

- Still concerns on the public debt…expect to be above 82%...interest rate
- But more than public debt, servicing the debt becoming a serious issue ..in the last three years, the interest payment as a ratio to total receipts increased from 22% to 25%
- This time with increasing foreign interest rates, the interest payments on external debt increased from 12667 crore to 32597 crore (BE) – a three times increase
- In 2024-25, BE, market borrowing is pegged at 16.9 lakh crore, lower from 17.3 lakh crore in 2023-24, this should bring down yields .
- For the third consecutive year, Budget skipped medium term expenditure framework that is part of the compliance obligations under FRBM Act
- El Nino impact appears to be incomplete, some decline in area under cultivation
- There appears to be trade-off between private consumption and investments
- Policy interest rates are sticky, but expected to move downwards following US Fed policies. But pressure on deposits and bond yields

Introduction.

- But major concern is on the global developments and its cascading impact on India (through trade, finance and inflation)
  - World GDP growth is expected to slow to 3% (IMF)
  - Many predict recession (especially in advanced countries)…especially global trade growth expected to decline sharply…
  - ..following this global oil and commodity prices are cooling
  - Inflation in most advanced economies still much higher than their threshold level targets, thus, leading to stickiness in interest rates
  - Still abetting wars in Russia-Ukraine & Israel-Gaza and its impact on external account

Introduction.

- With global uneven recovery (with increased fear of slowdown) to be almost a reality…how is India going to absorb such external shocks?
  - As in the past, shocks to trade to be long lasting – through raising tariffs, exchange rate, Oil prices, invisibles, capital flows, global demand, …
  - But prudent macro policies by India should reduce such risks on growth and inflation…(lessons of post-2008 mis-steps)
  - RBI Governor termed global conditions as – "VUCA' (volatility, uncertainty, complexity and ambiguity)
  - …there were some discussions on stagflation in India?!!
  - But this recovery in growth sustain? And what needs to be done to sustain despite with global headwinds?
  - In our view, quickly reverting back to the original FRBM Act of 2003…

FRBM Act…current status

- Adopted the Fiscal Responsibility Budget Management (Act) in 2003…but amended in 2018 for Union
- Under the original Act, following targets have been fixed
  - Fiscal deficit (as % of GDP) should be equal to 3%
  - Revenue deficit (as % of GDP) should be equal to zero
  - Public Debt (as % of GDP) should be at 60% (Centre plus states)
- Adopted at both Union and States…it was stringent on states while Union postponing the goals…but achieved in 2007-08
- Every Finance Commission has revised it depending on the prevailing macroeconomic conditions
- In 2018 Finance bill, amendment has been carried out and dropped Revenue deficit target
- 15^{th} FC made ‘indicative’ recommendations…Union is yet to formulate new rules
- But most importantly, FRBM is a
  - Macro consistent framework
  - Ensures quality of expenditure
  - Helps in expenditure switching (not expenditure compression)
- Intrinsically, it is the fiscal multipliers that helps in understanding macro-consistency

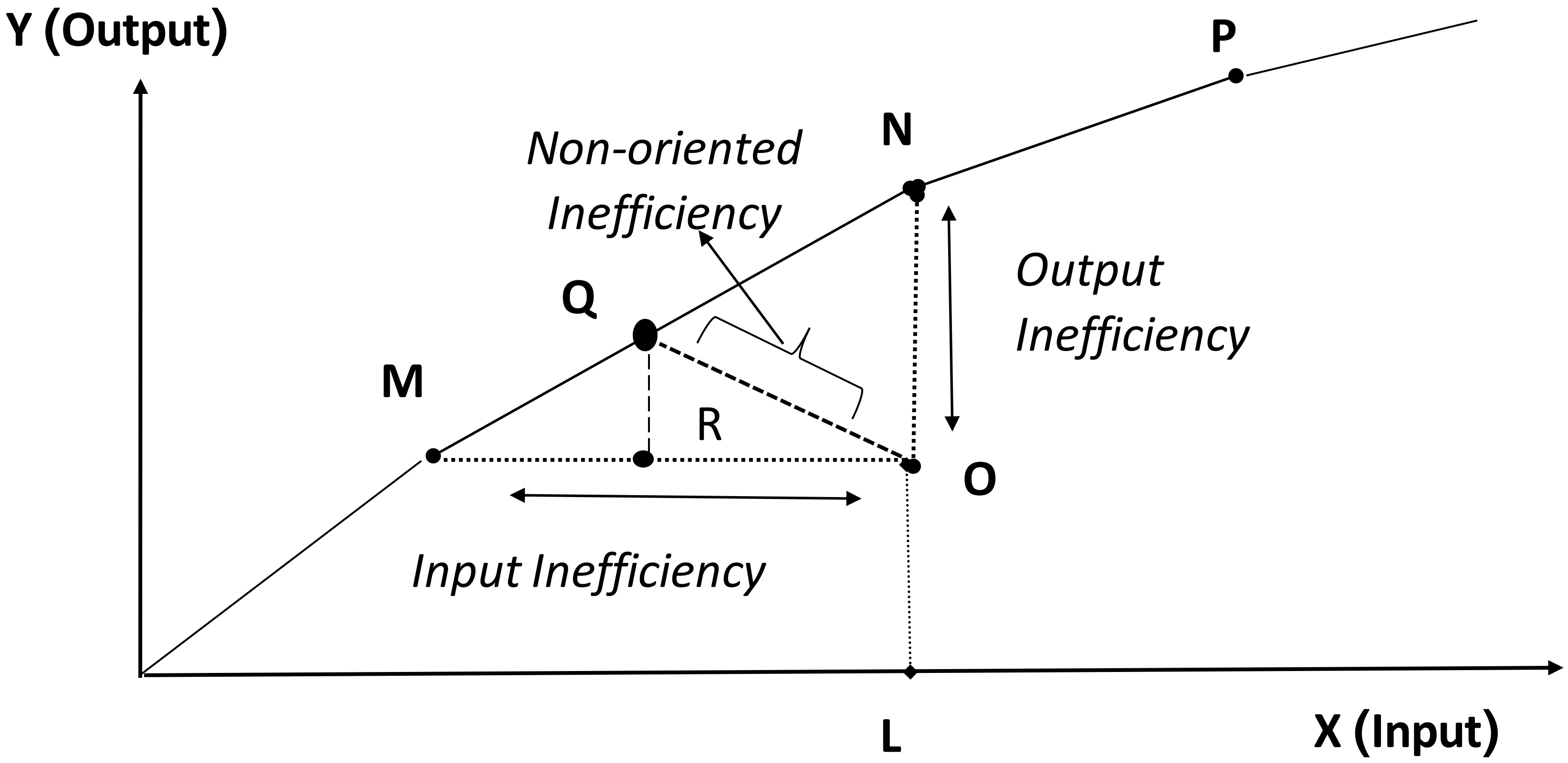
FRBM act…current status

- What is the size of mutlipliers?
- NIPFP study suggest capital expenditure multiplier at 2.45 (cumulative multiplier of 4.7) while revenue expenditure at 0.98
- But recent estimates suggest a time-varying multipliers following the business cycles…higher during down-turn and lower during the upturn..
  - Revenue and Capex multiplier are at 1.5 and 3.6 during the down-turn while during the peaks they are 0.94 and 2.6, respectively
- Between Union and states, RBI study suggests lower size of multipliers for states compared to Union
- Union government’s focus on larger capex since last two Budgets to ensure recovery and balance growth-inflation…

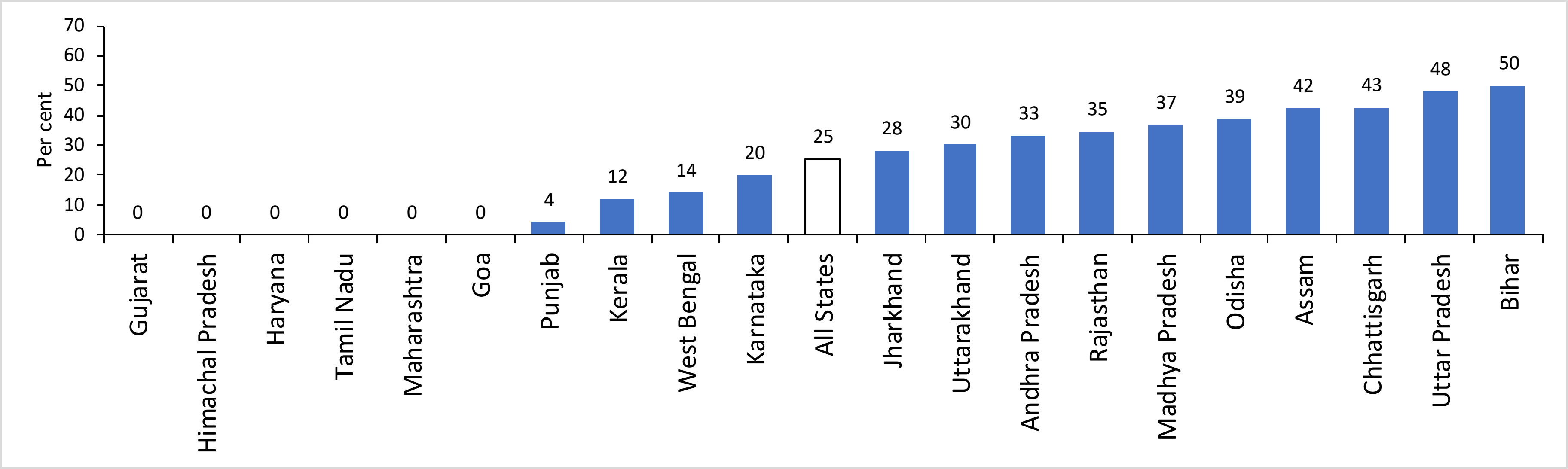
Emerging macro-fiscal concerns

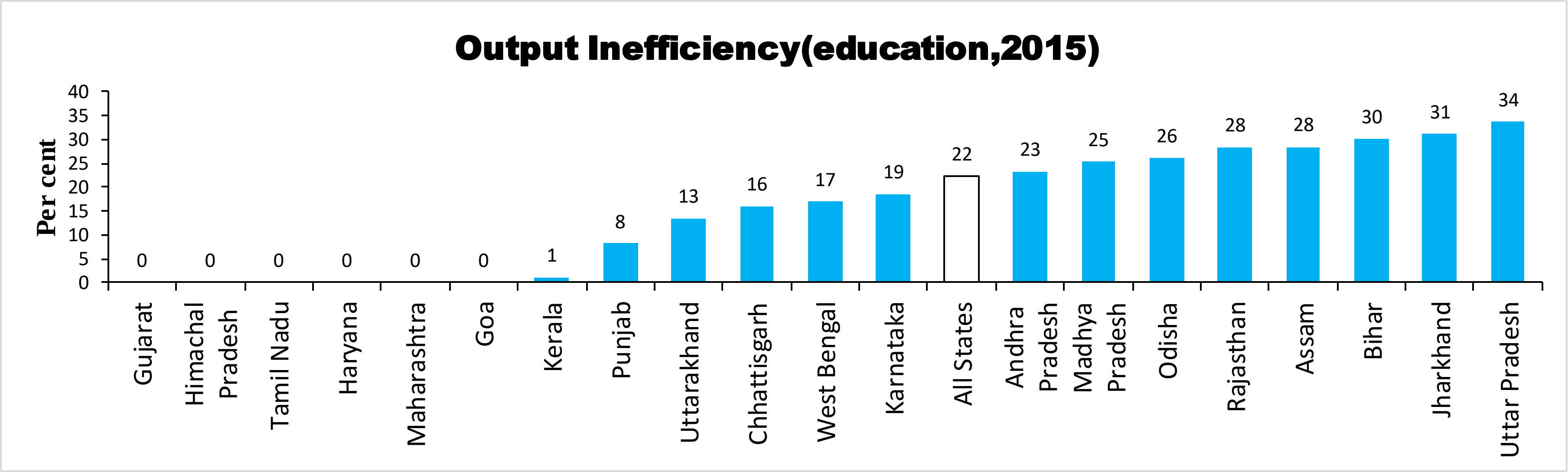
- Reverting to FRBM Act …is it premature fiscal tightening?
- Increasing debt levels (especially off-budget borrowings)– is it sustainable?
- State of state finances- especially since 2015-16 (OTR, devolution, GST, quality of expenditures, Old pension schemes, freebies….) (studies by NITI, RBI…)
- Continuation of incentive structure for capex at the states
- Ever increasing share of cess and surcharges (over 15% of GTR) – should it be brought within divisible pool?
- Issue of GST compensation
- Look at the unspent balances – especially at PRIs
- Fiscal stimulus through temporary reduction in tax rates?
- Macro policies for improving savings in the economy
- Relooking at the taxes on imports and exports
- Inconsistency between FRBM and FIT
- Above all, there is a need to talk about public expenditure efficiency…and what determines it?

Efficiency Frontier

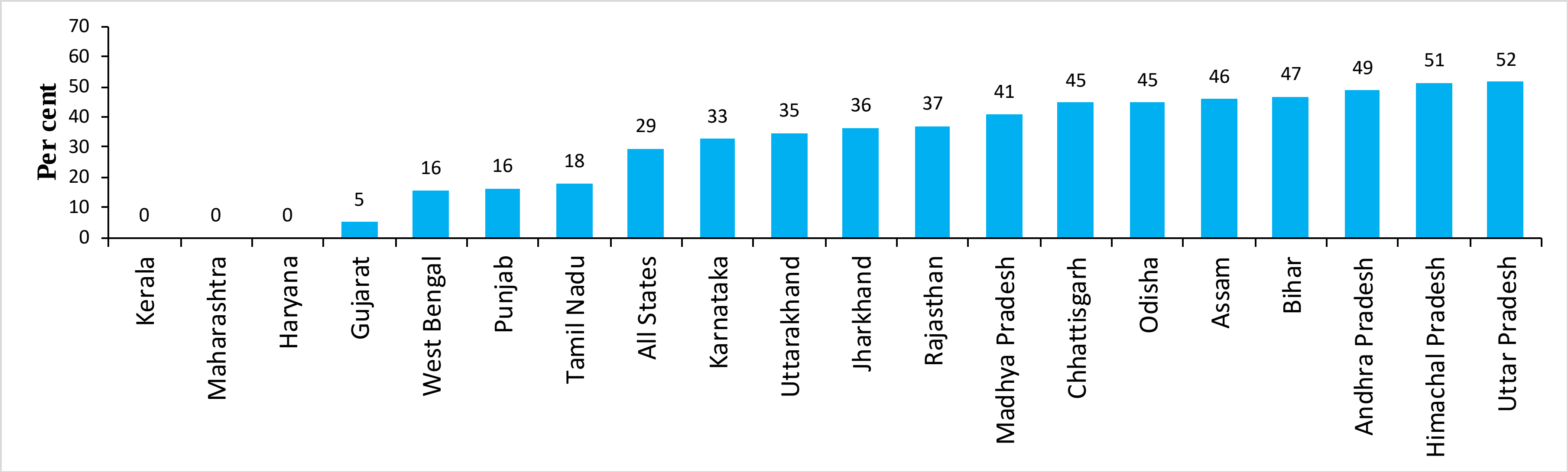


Input inefficiency (education, 2015)

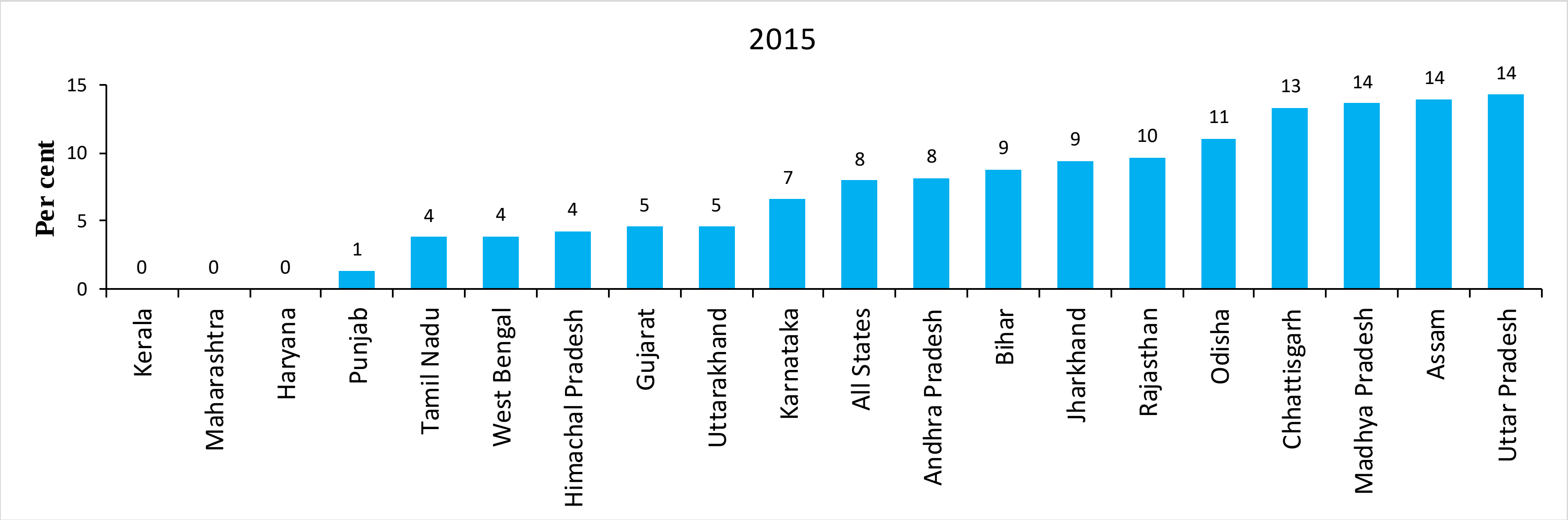


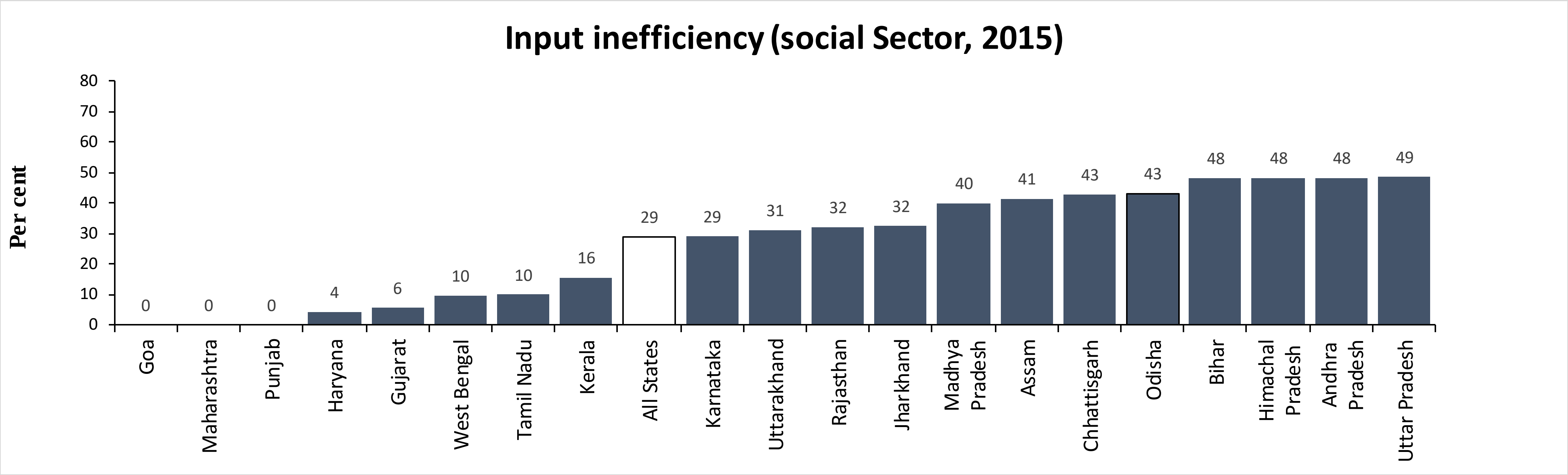


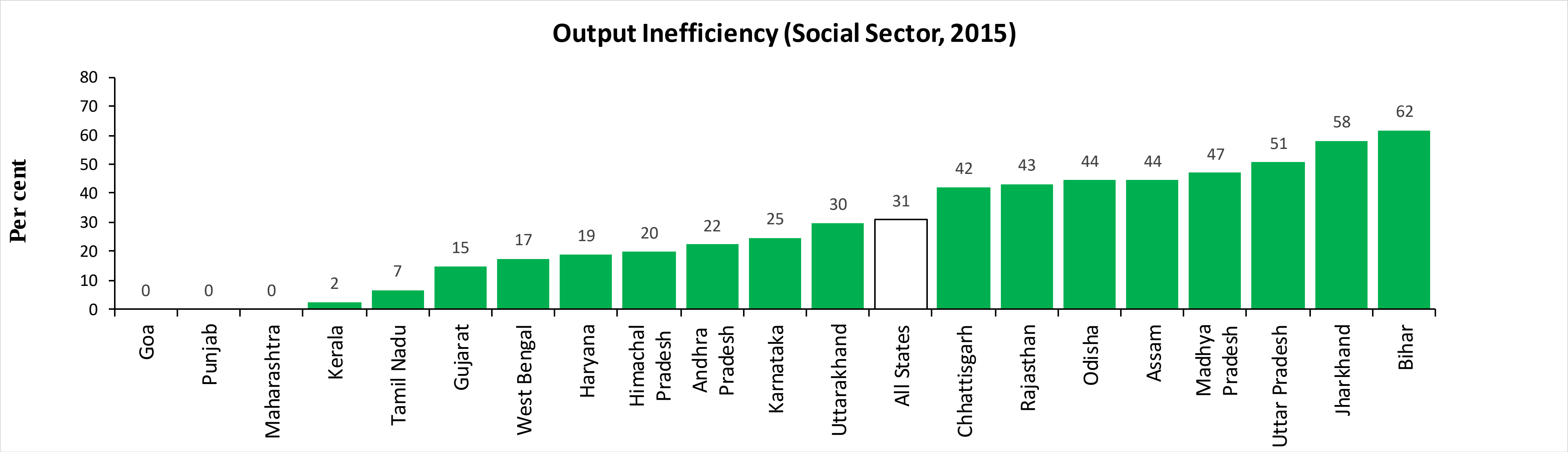
Input inefficiency (Health, 2015)



Output Inefficiency(health,2015)



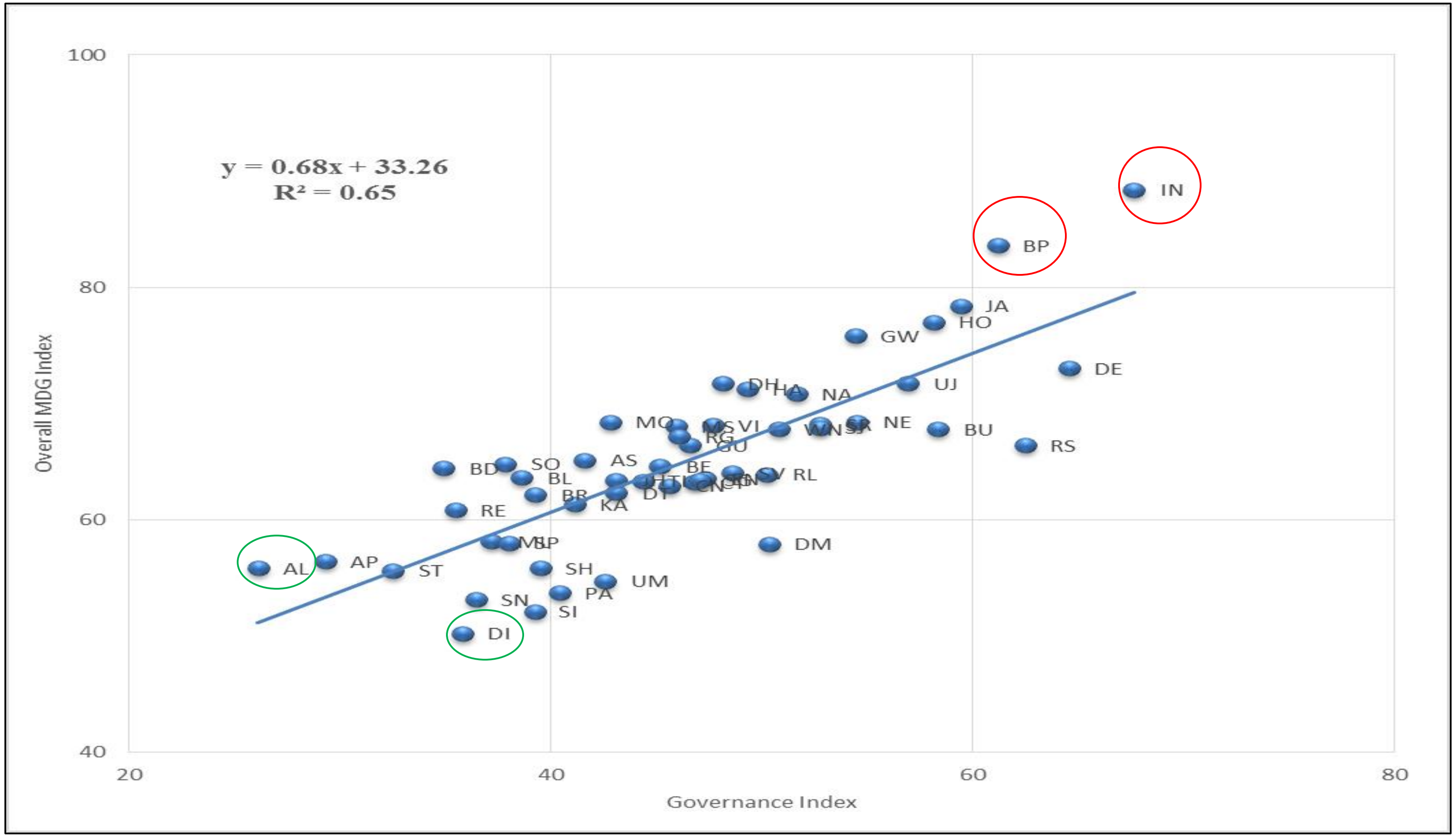

Input inefficiency (social Sector, 2015)
Per cent
80
70
60
50
40
30
20
10
0
0
0
0
4
6
10
10
16
29
29
31
32
32
40
41
43
43
48
48
48
49
Goa
Maharashtra
Punjab
Haryana
Gujarat
West Bengal
Tamil Nadu
Kerala
All States
Karnataka
Uttarakhand
Rajasthan
Jharkhand
Madhya Pradesh
Assam
Chhattisgarh
Odisha
Bihar
Himachal Pradesh
Andhra Pradesh
Uttar Pradesh


Output Inefficiency (Social Sector, 2015)
Per cent
80
70
60
50
40
30
20
10
0
0
0
0
2
7
15
17
19
20
22
25
30
31
42
43
44
44
47
51
58
62
Goa
Punjab
Maharashtra
Kerala
Tamil Nadu
Gujarat
West Bengal
Haryana
Himachal Pradesh
Andhra Pradesh
Karnataka
Uttarakhand
All States
Chhattisgarh
Rajasthan
Odisha
Assam
Madhya Pradesh
Uttar Pradesh
Jharkhand
Bihar

On public expenditure efficiency

- What determines public expenditure efficiency?
  - Resources (GDP and its percapita)
  - Institutions (governance)
  - Endowment (mothers' schooling)
- Some of the findings are
  - Wide variation in the public expenditure efficiency across the states
  - Western states are more efficient in public spending than the other regions.
  - Most of the eastern Indian states are far from efficiency frontier in public spending.
  - South Indian states are relatively better compared to Central Indian states.
  - Many states are spending their resources more efficiently on education than compared to health and overall social sector public spending.
  - Governance has a larger impact than percapita GSDP and mother's schooling on the efficiency of the education sector and social sector.

Relationship between Human Development and Governance



Thank you