Indian Economy: Some Contemporary Perspectives
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Lecture No. 35
Indian Economy - Fiscal Policy 2

So, let us start. So, welcome you all in this particular session. We are going to talk about the fiscal policy. In the previous session, we have already discussed the beginning phases. So, FRBM-I and now, we are going to shed light on the FRBM-II. So, FRBM-I gave the particular idea about that there will be some check on the government also so that, government can also have a have an understanding about the government expenditure.

And especially, how they are going to take measures in terms of maintaining the fiscal health of the country? So, for that reason, we had gone for the FRBM Act and it had put a check by putting a target of fiscal deficit of 3 percent of GDP and we were able to meet that.

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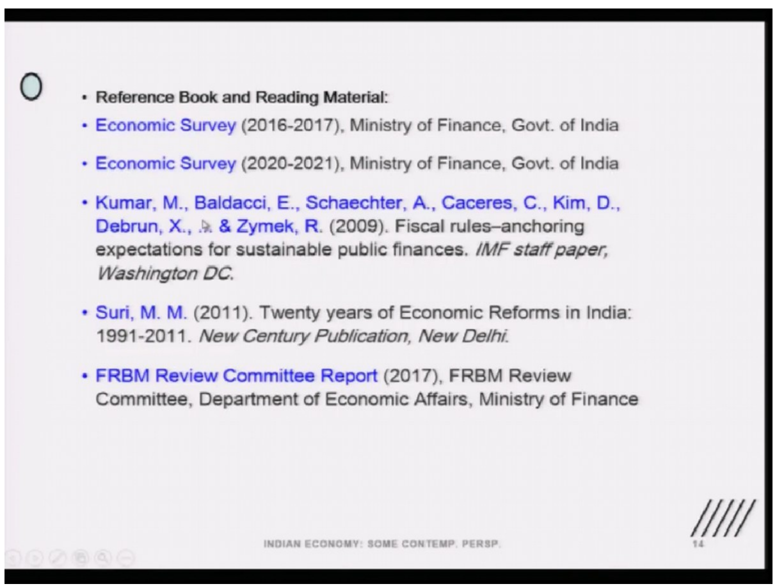

So here, it is about the reference book and reading material. So, we have, we have referred almost the same that I have already mentioned in the previous lecture. So, it remains the same in case you want to explore, you can explore these references.

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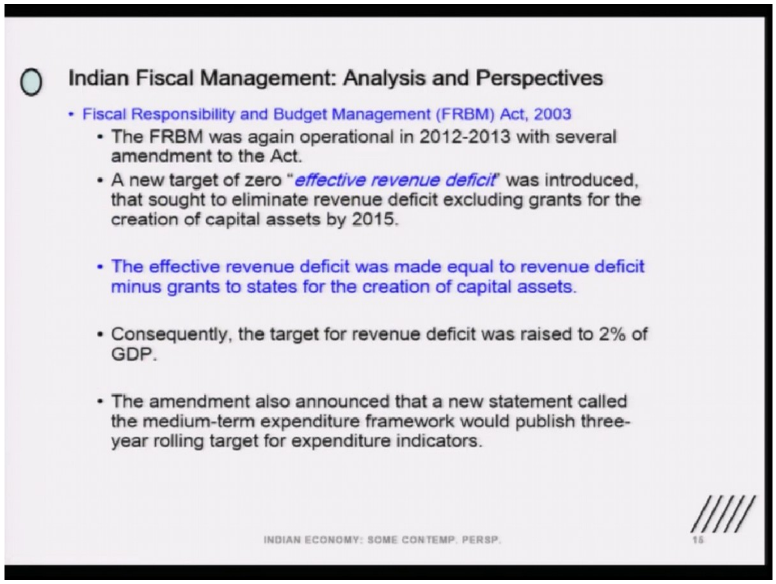

So, FRBM Act was again in operation at that time Pranab Mukherjee was the Finance Minister and he had come up with the concept of some kind of a new target of zero effective revenue deficit. It was meant to be get adjusted with the grants to the states for the creation of capital assets. So, whatever special grants or any kind of a special need based may payment is being made to the states that will be adjusted and they call that is an effective revenue deficit. And at that time under the finance act, this particular FRBM Act was again a made it operational.

So, effective revenue deficit has some kind it has been part of the debate and discussion that whether we should be focusing on this or we should simply go for the revenue deficit? But I think, there is no agreement that this particular indicator will be dropped. So, maybe after some time, we will not be able to see this particular indicator. But at that time, during 2015, it was there.

The target for revenue deficit was raised to 2 percent of GDP, because at that time, we had just recovered from the 2007-08 global financial crisis and at that time, we thought that it is always good to have some kind of expenditure. So, at that point of time, this was the part of the discussion. And then there are also announcement of the medium-term expenditure framework and whatever the rolling targets that were given earlier, it was fixed that it should be giving the rolling estimates of the 3 years and then it became the quite a prominent kind of exercise to be part of the FRBM process.

So, we had the FRBM-I, then there is suspension during global financial crisis and then again, we started in 2012-13. At that time, it was part of the Union budget.

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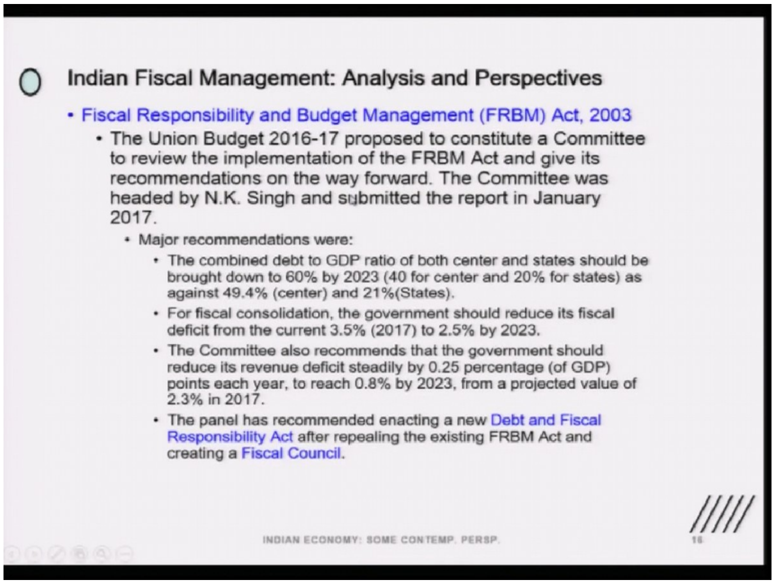

Then the Union budget 2016-17, we had the committee to review the FRBM Act, because at that time the 14th finance commission recommendation had also mentioned about it that there is a time to revisit the existing norms of the FRBM Act. So, that we can make it more aligned to the recent changes that we have seen because of the recent developments, that we had to undergo.

So, from fiscal policy side also, there is adjustments. So, in the same way that we had seen in case of monetary policy, that how from single indicator we focus on the multiple indicator, and how from the bank rate we arrive at the liquidity adjustment facility and the repo rate. In the same way government, it was also a desired that FRBM should be revisited and it should be aligned with the recent changes. So, the N. K. Singh has headed this committee and he submitted the report in January 2017.

The committee mentioned that the combined GDP target of both center and its states which is around 49.4 percent and the 21 percent for the states it should come down to 60 percent which means that 40 percent for the center and 20 percent for the states by 2023. So, this target has been given to the center plus the states that you have to reduce the debt to GDP ratio. In case of a state, it will be debt to GSDP ratio because we have the gross state domestic product over mentioned there.

For fiscal consolidation, the government should reduce a fiscal deficit from the current 3.5 percent which was there in 2017 to 2.5 percent. So, now it is going to be more restrictive. So, this review committee has suggested that instead of targeting 3 percent, which was the target in the FRBM-I Act now, it is going to be 2.5 percent by 2003. But considering that we are now in a completely different phase of the economy, so it will not be able to maintain and now, I think the FRBM Act for some time it will not be in reach of meeting the target.

The committee also recommends that the government should reduce its revenue deficit by 0.25 percentage points each year to 0.8 percent by 2023 from the 0.25 percentage to 0.80 it has to go, which means that it requires the whole lot of understanding about how they will be going for expenditure cut. The uniqueness of this plan is that the panel has suggested that this FRBM Act will now be called under the Debt and Fiscal Responsibility Act because debt is now going to be the one component.

And as it has been mentioned that I mentioned in the beginning about the fiscal rule, so there we had debt to GDP ratio and the budget balance both coming together. So, this, the India is now moving towards the debt and the fiscal integrated also. It has taken the path of both. Rather than simply keeping in mind about the tax.

One more unique thing that the committee recommends is the fiscal council. So, this fiscal council, the committee recommended that there should be a committee formed by the senior experts those who are in the area of finance and these experts will be outside from the not from the existing pool of the individuals. This particular guy will come from outside and the senior person will be expert in the public finance and he will be given the task to give a particular framework or scenarios for managing this.

So, 2.5 percent it will not be just left to the government to manage by own. There will be committee of fiscal council and this committee will use the data resources of the government to recommend the government that where this particular government has been heading and how they can go for in which areas so, there is a detailed discussion about that how this fiscal council will help the government to ensure that these targets are met on time, with the data analysis, with the backend research, with the scenarios, forecasting, projections, everything it will do.

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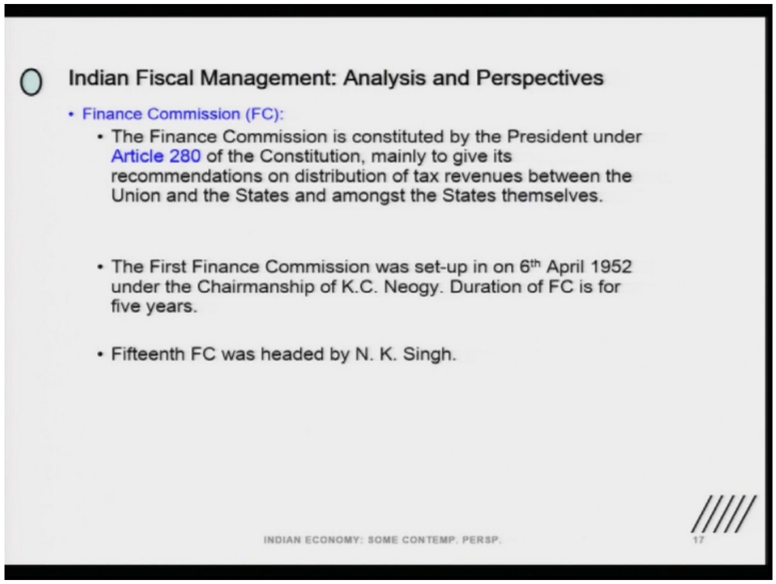

Then in India we have very important institution that takes care the distribution of resources between center and states. So, center collects the taxes direct, indirect. And then the center as per the finance commission recommendation, it gives the share to the states and it shares the revenue to the states that is called tax devolution. So, as per the 14-finance commission the tax devolution rate was recommended to be the 42 percent whatever is the total amount. So, if the government is going to have the tax revenue of total tax revenue of 100 rupees, 42 rupees is recommended to the states that it will be distributed to the states.

But for that also, the committee has different criteria to decide about, I will shed light on those criteria also. The finance commission is constituted by the president under the Article 280 of the constitution. And it gives the recommendations about the tax revenues between the union and the states and among us the states themselves. The first finance commission was set up on the 6th April, 1952 under the chairmanship ship of K.C. Neogy and the duration of this is 4 or 5 years. The 15 Finance Commission was headed by the N. K. Singh and this committee is important.

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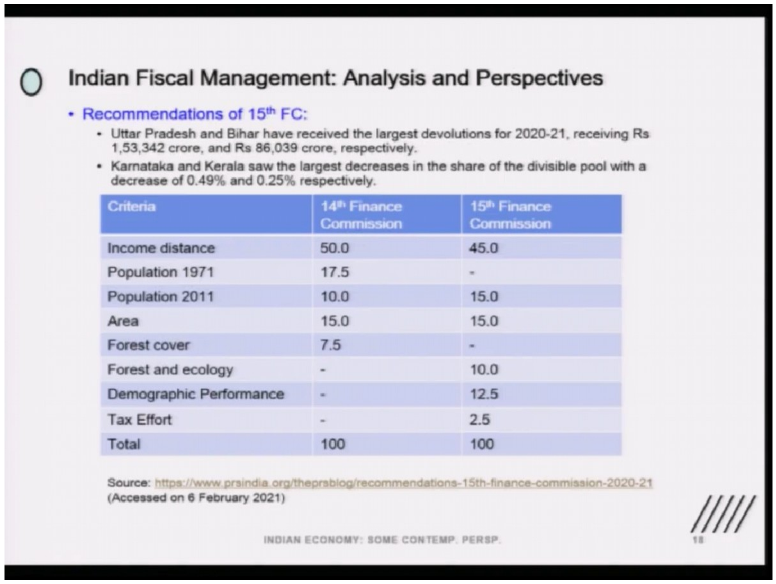

Now, I would shed light on the 15 Finance Commission recommendations. So, in case of 15 Finance Commission, what is more important to note is that criteria that was used, so the weights have been given for different indicators. So, these are the weights given. So, the sum is 100. So, the 14 Finance Commission has given the weight income distance that what is the national average and how much the states are deviating from the national average.

So, that is the based on the per capita income and then the population of 1971 population of 2001. So, the population of 1971 the weight is 0 as per the 15 Finance Commission but 14 Finance Commission has given the weight of 17.5 percent. So, it is now 0 and the population of 2001 the weight has been given to 15. So, which means that the 12.5 weights are adjusted somewhere else because 10 was for the population 2011 here, and now, it is 15 here.

The area that we have it remains the same. The forest cover it gives us 7.5, the 15 Finance Commission for forest cover it does not give anything then your forest and ecology it gives 10. Demography performance, it gives 12.5. The tax effort that the governments have made in collecting the taxes whatever at the local level or the state level whatever octroi and whatever is in the hand. So, it is 2.5.

So, this is the waiting pattern and based on this waiting pattern, what it has been found that the U. P. and Bihar, Uttar Pradesh and Bihar have got the largest devolution for 2020-2021, receiving rupees 153,000 crore and 86,000 crores respectively. Karnataka and Kerala saw the largest decrease in the share of divisible pool with a decrease of 0.49 percent and 0.25 percent respectively.

Now, this particular aspect is important to deal because sometimes for cooperative federalism it is always important that the weights that we assign it should not be biased towards some states, because it has been argued that the most of the states which are population reach, which means that they have the large population, they end up getting the highest share in the revenue by default,

But those states which are efficient in managing the population plus the economic activity, they get the limited share. So, there are different ways to compensate the losses, but as per the 15 Finance Commission report, this is what it looks like.

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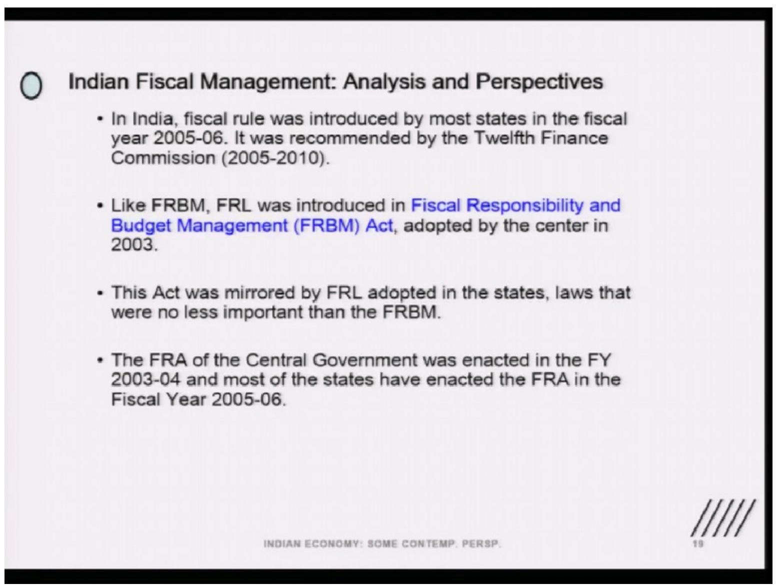

And then in India, similar to what we had the state level, we had the center level FRBM Act. The 12 Finance Commission had also recommended for the state level announcement. So, for the first time, I read a separate dedicated chapter in the economic survey 2016-17 volume one and that had mentioned that how states have done better in managing the finances some states are a laggard.

So, there was a comparative analysis of states mentioning about the Fiscal Responsibility Act. And at the state level, and so like FRBM, so in India, most of the states had recommended this the based on the recommendation of the 12 Finance Commission like FRBM, FRA was introduced in the fiscal responsibility. At the center the fiscal responsibility legislation was the implementation year adopted by the states with no less than this it had the same target like state. The FRA of the central government was enacted in the same way for fiscal year 2003-04 and most of the states had gone for an FRA in the fiscal year 2005-06. So, this was the case.

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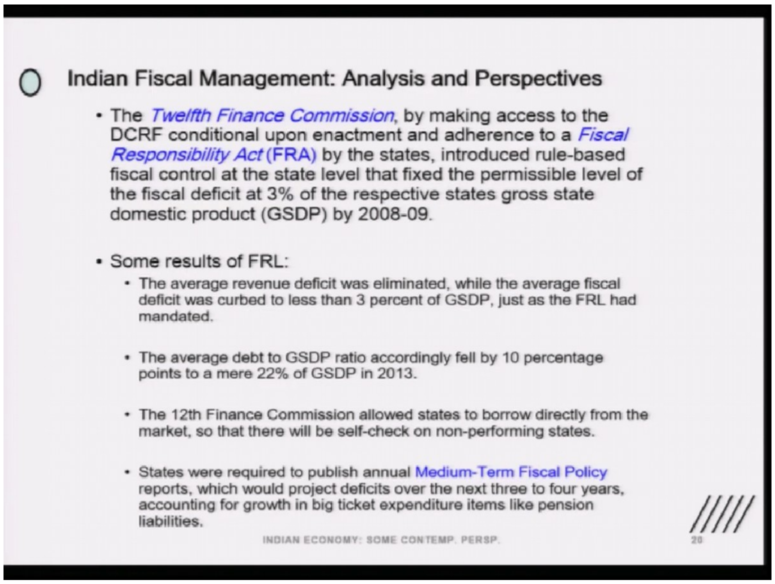

What is called the Fiscal Responsibility Act, FRA by the states. It has the rule-based target, so the target given to the states was that the fiscal deficit should be the 3 percent of the GSDP. So, at the country level, you have the GDP, at the state level you have the gross state domestic product. So, this target was given to the state. So, Fiscal Responsibility Act gave the target of 3 percent. The average revenue deficit was eliminated, while the average fiscal deficit was curved to less than 3 percent of GSDP just as the FRA had mandated.

So, some states it was found that the revenue deficit that they were targeting it had disappeared. The average debt to GDP ratio accordingly fells by 10 percentage point after this adoption. The 12 Finance Commission allowed also states to borrow directly from the market. And there will be some kind of self check, so just to ensure or just to promote the FRA act, so most of the states were given some kind of incentives to go for borrowing, even if they want.

In the same way that the central government has some kind of management rule so they come up with the medium-term plan, medium-term reports for the projection. In the same way, they also had the medium-term fiscal policy report. And that mentions about the rolling indicators of the expenditure and it was also mentioned over there. And for most of the investment with large investment also, it was quite adjustable and most of the states had some kind of accounting mechanism and with the prediction of three to four years. So, this was the recommendation of the committee.

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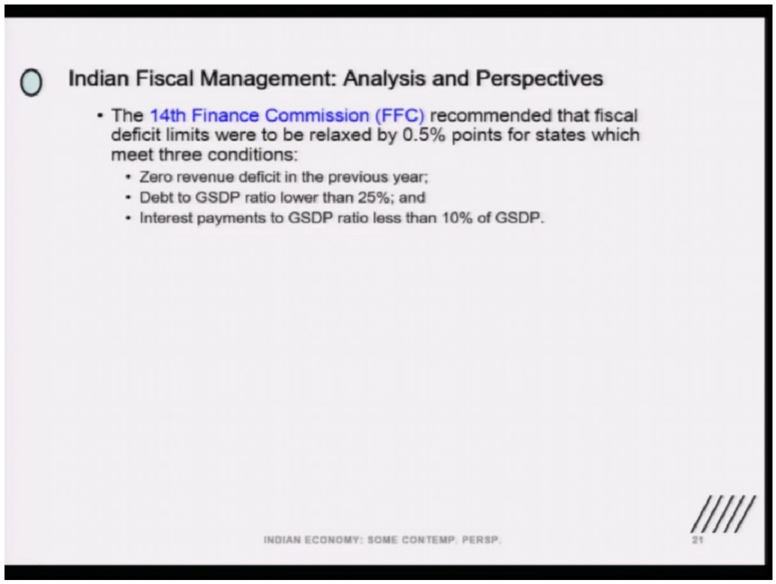

14 Finance Commission had recommended the limits of relaxed by 0.5 percent, zero revenue deficit for most of the states, debt to GDP ratio should be lower by 25 percent and interest payments to GDP ratio should be less than 10 percent GSDP. So, this one was the limit because in the first stance it was quite successful, so this was also recommended by the state.

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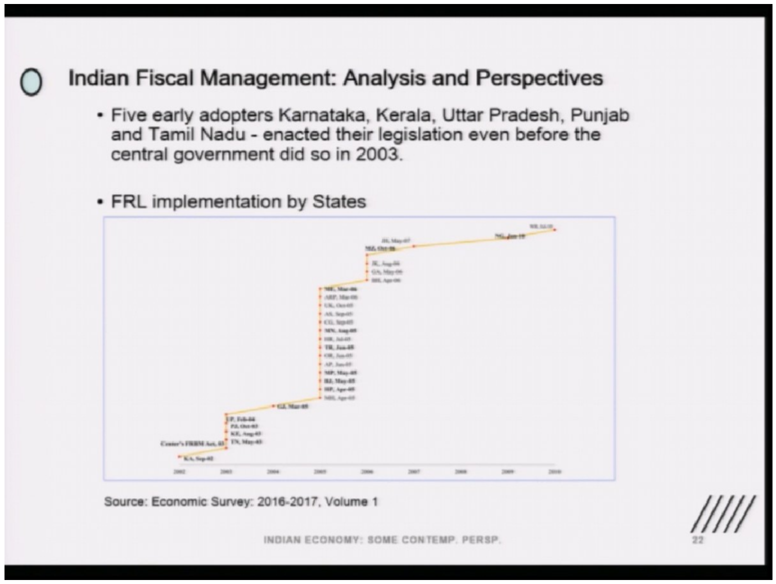

You will find that some states which had enacted much before then the central government, so that was the Karnataka. So, our early adopters were the Karnataka, Kerala. So, it was Karnataka, Kerala, Uttar Pradesh, Punjab, Tamil Nadu, so these were the states that had implemented the FRL Act much before that had gone for implementation of the FRL. In case of Karnataka, it was much ahead then most of the states.

So, some of the states even had the similar kind of implementation almost nearby the implementation from the center. So, this chart explains that which all states implemented the FRL Act, FRA Act at which time.

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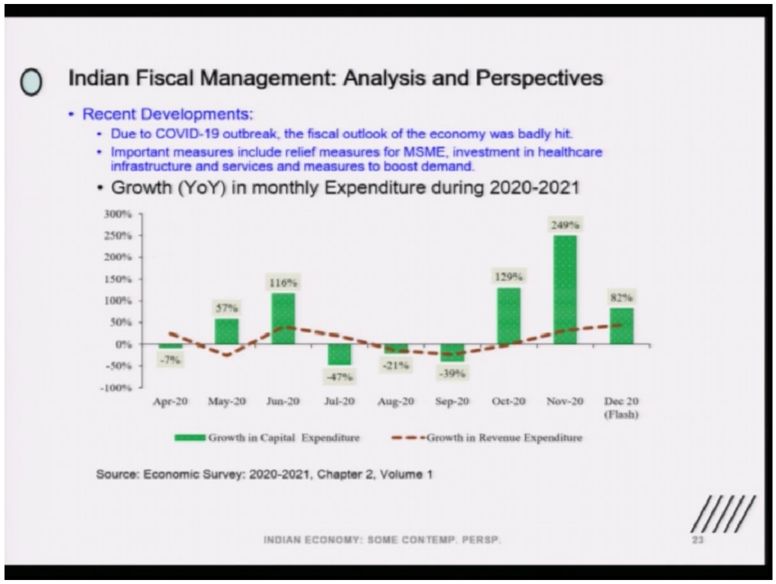

So, I also want to highlight some kind of recent developments that we will be talking about. So, in terms of recent developments, what has happened that it has been found that most of these states and at the country level also we were devastated by the coronavirus outbreak. So, it also gives the complete idea that in which all month there was monthly expenditure outlay decline and how it has been given relief measures in terms of MSE investment, investment in healthcare and other services.

So, this gives the clear-cut idea that how it has been implemented. So, here it is that in the first month of April when we were completely under lockdown and then post that May 2020 there were jump from 15 percent, 57 percent in May. Then there was June 116 percent, then there was July 20, we were down again by the 47 percent, 21 percent, 39 percent because at that time, we were completely in the peak periods. And then after that, we had the jump of in October 129 percent then again 249 percent and 82 percent.

So, this shows the pattern where the government has followed and when was the time when government had to take extra measures. So, in terms of capital expenditures, so this green shows the capital expenditure and this line you have it shows the revenue expenditure. Revenue expenditure means maintaining the existing resources, so giving salaries to the staff and all others.

But in terms of capital expenditure, we see that the first period that we had made the investment in May 2020, June 2020 that has must have paid dividends in the later months. And again, in October, November, we took measures and it became and by December 2020, we were able to at least have some stabilization in the program. So, almost like more than 100 percent here and more than 100 percent here is the jump.

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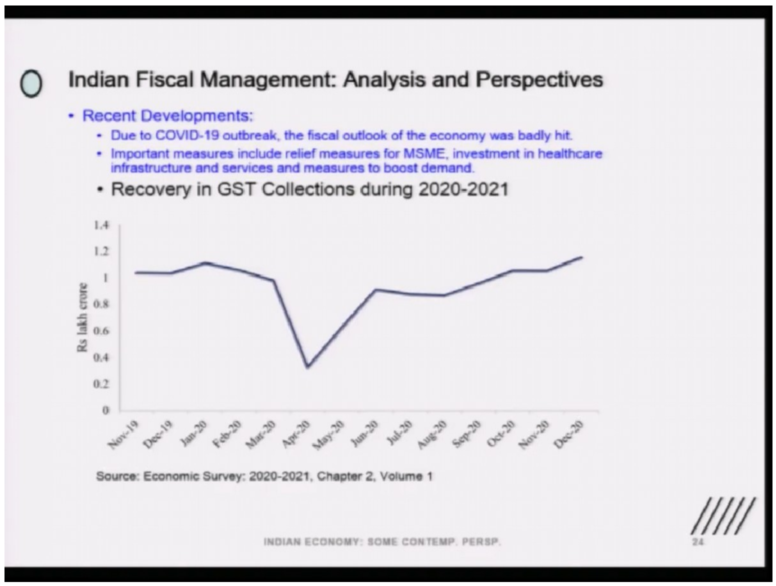

Even in terms of GST collection, it appears that in most of these indicators clearly reflect that November 2019, we had the very smooth chart, but after March 2020, when we had the lockdown, so especially, in April, it has the V-shape fall but it has the Versus-shape recovery. So, fall and recovery showed the V-shape. So, here it is that after April 2020 when we started opening up the Unlock-1 and Unlock-2 that we had. After that it has shown recovery and it has gone continuously. So, it clearly shows the impact.

So, this is not only in case of India, the economic survey mentions about the Atmanirbhar Bharat Scheme under that there is an investment of around 17 lakhs crores. And out of that the table mentions categorically each and every scheme that government had implemented and how much expenditure it has made. And if you just try and understand then you find that almost it covers the landscape of an aspect of the well being of the citizens and it has also gone for investing in almost every aspect including health and others.

So, the table gives the complete breakup that how we have gone. In the same way GST collection also, they try to justify with some arguments that during March and April, when we were in a completely shock condition at that time, we had the strongest fall. But after that, it has gone up and after that there was not much issue.

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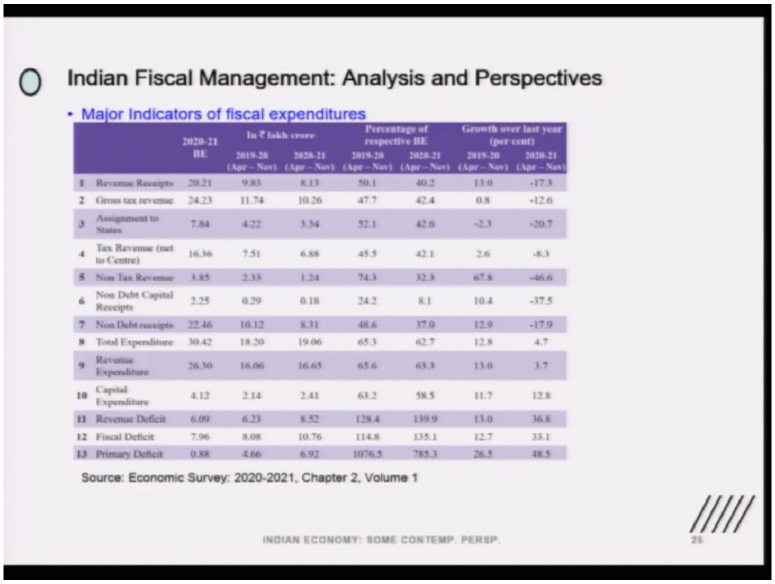

Indian Fiscal Management: Analysis and Perspectives

• Major Indicators of fiscal expenditures

		2020-21 BE	In ₹ lakh crore		Percentage of respective BE		Growth over last year (per cent)	
			2019-20 (Apr – Nov)	2020-21 (Apr – Nov)	2019-20 (Apr – Nov)	2020-21 (Apr – Nov)	2019-20 (Apr – Nov)	2020-21 (Apr – Nov)
1	Revenue Receipts	20.21	9.83	8.13	50.1	40.2	13.0	-17.3
2	Gross tax revenue	24.23	11.74	10.26	47.7	42.4	0.8	-12.6
3	Assignment to States	7.84	4.22	3.34	52.1	42.6	-2.3	-20.7
4	Tax Revenue (net to Centre)	16.36	7.51	6.88	45.5	42.1	2.6	-8.3
5	Non Tax Revenue	3.85	2.33	1.24	74.3	32.3	67.8	-46.6
6	Non Debt Capital Receipts	2.25	0.29	0.18	24.2	8.1	10.4	-37.5
7	Non Debt receipts	22.46	10.12	8.31	48.6	37.0	12.9	-17.9
8	Total Expenditure	30.42	18.20	19.06	65.3	62.7	12.8	4.7
9	Revenue Expenditure	26.30	16.06	16.65	65.6	63.3	13.0	3.7
10	Capital Expenditure	4.12	2.14	2.41	63.2	58.5	11.7	12.8
11	Revenue Deficit	6.09	6.23	8.52	128.4	139.9	13.0	36.8
12	Fiscal Deficit	7.96	8.08	10.76	114.8	135.1	12.7	33.1
13	Primary Deficit	0.88	4.66	6.92	1076.5	785.3	26.5	48.5

Source: Economic Survey: 2020-2021, Chapter 2, Volume 1

INDIAN ECONOMY: SOME CONTEMP. PERSP.

Similarly, here we have the major indicators of the fiscal expenditure. So, whatever we have done in the previous lecture, that we are going to see now and this will give you the idea that how we can understand, at least we can follow-up something. So here, it talks about the revenue deficit, it appears to be 6.23 now it is going to be, in 2020-21 it is going to be 8.52. In the same way the fiscal deficit, it is also 7.96 and in 2019-20 it was 8.06 and now, it is going to be 10.76 which means that 10 lakhs core it is going to be, it is in lakhs core. But normally, the fiscal deficit is presented in percentage form. But here they have mentioned in the lakh's crores.

Similarly, we have the primarily deficit which is nothing but the fiscal deficit minus interest payments. So, this is also going to be positive 6.92, which means that government is going for borrowing for sure and it will require a huge amount of borrowing. Similarly, a revenue deficit if you see in terms of declines so 2019-20 we had the growth of 13 percent. But it is expected that in 2020-21 we will have 36.8 percent. But the idea is that here we have the gross tax revenue of 24.23 percent and the total expenditure of 30.42 percent which means that the deficit that we are going to have it is nothing but here we have the 6.09. Because this is what it looks like that the expenditure is going to be higher.

Net debt receipt also, it shows the same. Here we have the non-tax revenue which is going to be lower because in 2020-21 anyway, we are not having at that much capacity, we have just started opening up. So, it may take time for businesses to recover. In 2020-21 if you see by figures then it appears that each and every indicator is in negative growth that shows that how we are going to have this particular indicator functioning.

So overall, what it appears that here we are going to understand, these indicators represent the stress in the fiscal space of the country and how government is going to manage, though there are some rosy scenarios where in yes, we are arguing that the the economy will have V-shape recovery, but in actuality it will show, it will come out with the data that whether it is there or not. So, the pulse of the economy may be going in a right direction, but we will have to wait for at least six months to have a clear-cut idea that how it has gone so far.

So far what we have covered is this aspect of the fiscal policy. So, to conclude, what we have covered is that we have covered the FRBM Act. And in FRBM Act, we have understood that this FRBM Act gave idea for management at the center level. So, it was implemented also at the state level at the same time and this state level idea given by the 12 Finance Commission had paid dividends for the states, because some states have done well and some states have implemented the FRBM Act much before then the center and this gives a complete idea that how the role of the central government is important and how states comments are also going for some kind of cooperative federalism where they are also having the similar kind of sets ups.

The medium-term reports that I had mentioned for the FRBM Act required, it also gives the idea for the states. So, the overall understanding is that going ahead the fiscal space in India is going to be much more competitive because after the FRBM Review Committee recommendation there is going to be the formation of Fiscal Council and this Fiscal Council will keep an eye on the real time data collection and also on analyzing data and giving estimates to the government that how they should be able to meet the target.

And the second aspect is the importance of the Finance Commission because Finance Commission as per the 15 Finance Commission, we saw that this particular Commission has given more weight and there had been some adjustment with regard to the weights. And these adjustments are also indicating that some states which are high income states are going to lose money and even and those states which are more by population going to get share. So, this may also create trouble.

There was one important issue that that I wanted to deal in detail, but because of the paucity of time I did not discuss is the tax devolution rate that we have. So, in India, the target is that the revenue deficit should go away as soon as possible. But so, the this is also the revenue expenditure side should not be taken care that much. But it should be the capital expenditure side that should be given.

And the states are also contesting with this enter that since as per the recommendation of the 14 Finance Commission, the higher tax devolution was recommended. But at the same time central government guided that there will be some adjustment with regard to the support given to the central scheme. So, that also became one of the debated topics.

One more debated topic was the fall in the GST earnings and as a result the government had not given that much support in terms of the tax share, tax revenue share with the state. So, if you could remember it had become one of the important topics when Chief Ministers were not happy that how they will be dealing with pandemic, if they are not given the timely devolution. So, those aspects are important to note.

Another aspect that I thought I should be touching upon is the role of GST because 2017-18 Economic Survey and even 2018-2019 Economic Survey mentions about the successes of the GST because in the beginning, it has not given the right kind of signal. But after one year it was some kind of some kind of infrastructure related issue and that was sorted out. So, that has also started giving us some kind of positive outcome. But given that, the economy is in a completely different time and it may need some more years to come back to that stage where we can again start debating on which all measures should be implemented or which are not.

So, for this particular course, I think these two lectures will be sufficient to give the idea about the India’s fiscal policy and which all indicators are important. Keep in mind that the fiscal deficit is one indicator that we all should bother about and the both legs of the policy, fiscal and monetary are important for the management of the overall economy.

So, from the beginning if you trace down these two so we were relying more on taxes, but the post-1991 period if we had the services sector booming. So, that has also given a lot of boost to the tax revenue and this resulted in coming to this stage. So, I will conclude with this. Thank you. Thank you so much.