Macroeconomic Framework of Union Budget 2021–22: Reconsidering the Fiscal Rules

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Abstract

Extraordinary times require extraordinary policy responses. Against the backdrop of macroeconomic uncertainty due to the CoVID-19 pandemic, the union finance minister has announced a high fiscal deficit of 9.5% of gross domestic product (GDP) in revised estimates (RE) 2020–21. This is against the pegged deficit of 3.5% in budget estimates (BE) 2020–21. Simultaneously, the finance minister has also announced an excessive deficit procedure to bring down the high fiscal deficit to 4.5% of the GDP by financial year (FY) 2026. High deficit has no fiscal costs if it can be substantiated with increased public investment or "output gap" reduction. When the monetary policy stance has limitations in triggering growth through liquidity infusion and the status quo policy rates, "fiscal dominance" is crucial for sustained growth recovery.

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Reconsidering Fiscal Rules

Globally, there is a fundamental rethinking about the efficacy of "fiscal rules"—whether adhering to numeric threshold ratios of deficit is growth-enhancing. If the path to fiscal consolidation is through expenditure compression rather than increased tax buoyancy, the quality of fiscal consolidation gets affected. Chapter 2 of the Economic Survey 2021 on public debt sustainability, highlights the perspective of the eminent macroeconomist Olivier Blanchard (2019b: 1198) that "if the interest rate paid by the government is less than the growth rate, then the intertemporal budget constraint facing the government no longer binds." From this perspective, as announced in the Union Budget 2021, allowing a high fiscal deficit to GDP ratio to 9.5% of GDP in RE 2020–21 is welcome.

In his presidential address to the American Economic Association (AEA), Blanchard (2019a) explained that "public debt has no fiscal costs if real rate of interest is not greater than real rate of growth of economy." It was also highlighted that high public debt is not catastrophic if "more debt" can be justified by clear benefits like public investment or "output gap" reduction. His analysis highlighted the "hysteresis effects"—the persistent impact of short-run fluctuations on the long-term potential output—and he suggested that a temporary fiscal expansion during a contraction could even reduce debt on a longer horizon. These perspectives are incorporated in the Economic Survey 2021 while analysing the debt–deficit dynamics.

The anatomy of the high fiscal deficit number announced in the Union Budget 2021 is relevant here. It is a combination of revenue shortfall, and new expenditure priorities. Strengthening of "budget transparency" by incorporating prior off-budget borrowings has also led to the rise in deficit number. The Food Corporation of India's (FCI) borrowing from the National Small Savings Fund (NSSF) is stopped, to bring in budget transparency. When FY2021 fiscal deficit has reached 9.5%, the government envisions to borrow another `80,000 crore in the next two months. For FY2022, the fiscal deficit is pegged at 6.8% of GDP (Table 1).

The existing fiscal rules were amended to incorporate the revised threshold of deficit to GDP. In the 2018 amendment to the Fiscal Responsibility and Budget Management (FRBM) Rules 2004, the "golden rule" of zero revenue deficit was eliminated and the clauses related to the elimination of "revenue balance" were incorporated in the financial bill. However, in 2021–22 BE, revenue deficit is 5.1% of GDP. Though there was a debate within the FRBM committee regarding the choice of deficit, whether revenue deficit, fiscal deficit or primary deficit as the "operational deficit parameter" in India—with Arvind Subramanian's dissent note favouring the primary deficit (fiscal deficit minus interest payments), the Union Budget 2021 reiterated that fiscal deficit is still the operational concept of deficit in India. However, primary deficit is a useful concept to understand the current fiscal stance of the government, without the legacy of interest payments.

Table 1: Levels of Deficit (Rs crores)

	2019-20	2020-21	2020-21	2021-22
	Actuals	Budget Estimates	Revised Estimates	Budget Estimates
Fiscal Deficit	933651	796337	1848655	1506812
	(4.6)	(3.5)	(9.5)	(6.8)
Revenue Deficit	666545	609219	1455989	1140576
	(3.3)	(2.7)	(7.5)	(5.1)
Effective Revenue Deficit	480904	402719	1225613	921464
	(2.4)	(1.8)	(6.3)	(4.1)
Primary Deficit	321581	88134	1155755	697111
	(1.6)	(0.4)	(5.9)	(3.1)

Source: Government of India (2021), Union Budget documents

Extreme precaution is required when we measure "deficits" in the time of pandemic. It may be incorrect to think that "cyclically neutral fiscal deficit" is a better measure of deficit. It is important to analyse whether "disruptions" or "downturns" are just "cyclical" and transitory; or whether it "permanently" leaves a scar and depresses the level of output and employment. If it is a "drop" from the trend growth rather than a "deviation," it is incorrect to assume that an upturn in business cycle can eliminate the "cyclical" part of deficit. Undoubtedly, such things cannot happen if there is no return of the economic growth cycle to the prior trend growth path, and therefore this could mean that the buoyancy of revenue receipts could remain below the prior-potential level.

In an economic downturn, if we are worried about a "bad equilibrium" of rising debt and deficits, it is better to have a "contingent fiscal rule"; however, "keep the fiscal rules, but do not use it" (Blanchard 2019a). In addition, Blanchard also argues against the "steady" fiscal consolidation. Similarly, "a uniform and rigid fiscal rule not only undermines the fiscal autonomy of the states, but would also result in 'public (developmental) expenditure compression' to comply with numerical threshold ratio" (Reddy and Reddy 2019: 74).

The sources of financing the fiscal deficit in the Union Budget 2012 show that gross market borrowing (`12 lakh crore at 68.9% of total borrowings) is the dominant financing mode. The NSSF constitutes around 26% of the total borrowings (Table 2, p 21). The deficit incurred through off-budget borrowings through public sector enterprises can be captured better through the construction of "Public Sector Borrowing Requirement" (PSBR) data. However, the Union Budget 2021 has not introduced this new deficit concept of PSBR. Instead, the details of such extra budget borrowings are still kept in an annexure in the union budget document.

Table 2: Sources of Financing Fiscal Deficit (Rs crores)

	2019-20		2020-21		2020-21		2021-22	
	Actual	**% of Total**	**Budget Estimates**	**% of Total**	**Revised Estimates**	**% of Total**	**Budget Estimates**	**% of Total**
Debt Deficit (Net)								
Market Borrowings (G-Sec + T Bills)	624089	66.84	535870	67.29	1273788	68.9	967708	64.22
Securities against Small Savings	240000	25.71	240000	30.14	480574	26	391927	26.01
State Provident Funds	11635	1.25	18000	2.26	18000	0.97	20000	1.33
Other Receipts (Internal Debt and Public Account)	44273	4.74	50848	6.39	39129	2.12	54280	3.6
External Debt	8682	0.93	4622	0.58	54522	2.95	1514	0.1
Draw Down of Cash Balance	4971	0.53	(-)53003	(-)6.66	(-)17358	(-)0.94	71383	4.74
Grand Total	**933651**	**100**	**796337**	**100**	**1848655**	**100**	**1506812**	**100**

Source: Government of India (2021), Union Budget documents

In the Union Budget 2021, creating fiscal space for an economic stimulus package was a matter of concern. In a regime of revenue uncertainties, the Union Budget 2021 announced the asset monetisation programme, to generate revenue proceeds. The revenue shortfalls of tax and non-tax revenue are significant (Table 3, p 21). The disaggregate analysis shows that the fiscal slippage from the disinvestment proceeds is the highest. In other words, the "fiscal marksmanship" ratio (BE to RE ratio) is highest for disinvestment proceeds (last column of Table 3). Though asset sale is perceived as the prominent source of fiscal proceeds, it constitutes only around 5% of the entire receipts budget.

Table 3: The Composition and Fiscal Marksmanship of Revenue Receipts

(In ₹ crore)					In per cent				
	2019-20	**2020-21**	**2020-21**	**2021-22**	**2019-20**	**2020-21**	**2020-21**	**2021-22**	**2020-21**
	Actuals	**Budget Estimates**	**Revised Estimates**	**Budget Estimates**	**Actuals**	**Budget Estimates**	**Revised Estimates**	**Budget Estimates**	**Fiscal marksmanship/ fiscal slippage**
REVENUE RECEIPTS									
1. Tax Revenue									
Gross Tax Revenue	**2010059**	**2423020**	**1900280**	**2217059**	74.96	78.28	54.80	64.98	1.28
a. Corporation Tax	556876	681000	446000	547000	20.77	22.00	12.86	16.03	1.53
b. Taxes on Income	492654	638000	459000	561000	18.37	20.61	13.24	16.44	1.39
c. Wealth Tax	20	-	-	-	0.00				
d. Customs	109283	138000	112000	136000	4.08	4.46	3.23	3.99	1.23
e. Union Excise Duties	240615	267000	361000	335000	8.97	8.63	10.41	9.82	0.74
f. Service Tax	6029	1020	1400	1000	0.22	0.03	0.04	0.03	0.73
g. GST	598750	690500	515100	630000	22.33	22.31	14.85	18.47	1.34
- CGST	494072	580000	431000	530000	18.43	18.74	12.43	15.53	1.35
- IGST	9125	-	-	-	0.34				
- GST Compensation Cess	95553	110500	84100	100000	3.56	3.57	2.43	2.93	1.31
h. Taxes of Union Territories	5835	7500	5780	7059	0.22	0.24	0.17	0.21	1.30
Less - NCCD transferred to the NCCF/NDRF	2480	2930	5820	6100	0.09	0.09	0.17	0.18	0.50
Less - State's share	**650678**	**784181**	**549959**	**665563**	24.27	25.34	15.86	19.51	1.43
1a Centre's Net Tax Revenue	**1356902**	**1635909**	**1344501**	**1545397**	50.60	52.85	38.77	45.29	1.22
2. Non-Tax Revenue	**327157**	**385017**	**210653**	**243028**	12.20	12.44	6.07	7.12	1.83
Interest receipts	12349	11042	14005	11541	0.46	0.36	0.40	0.34	0.79
Dividends and Profits	186132	155396	96544	103538	6.94	5.02	2.78	3.03	1.61
External Grants	373	812	1422	747	0.01	0.03	0.04	0.02	0.57
Other Non Tax Revenue	126540	215465	96602	124671	4.72	6.96	2.79	3.65	2.23
Receipts of Union Territories	1762	2303	2081	2531	0.07	0.07	0.06	0.07	1.11
Total- Revenue Receipts (1a + 2)	**1684059**	**2020926**	**1555153**	**1788424**	62.81	65.29	44.85	52.42	1.30
					0.00	0.00	0.00	0.00	

3. CAPITAL RECEIPTS					0.00	0.00	0.00	0.00	
A. Non-debt Receipts	**68620**	**224967**	**46497**	**188000**	2.56	7.27	1.34	5.51	4.84
(i) Recoveries of loans and advances@	18316	14967	14497	13000	0.68	0.48	0.42	0.38	1.03
(ii) Disinvestment Receipts	50304	210000	32000	175000	1.88	6.78	0.92	5.13	6.56
B. Debt Receipts*	**928680**	**849340**	**1866013**	**1435428**	34.63	27.44	53.81	42.07	0.46
Total Capital Receipts (A+B)	**997301**	**1074306**	**1912510**	**1623428**	37.19	34.71	55.15	47.58	0.56
4. Draw-Down of Cash Balance	**4970**	**-53003**	**-17358**	**71383**	0.19		-0.50	2.09	
Total Receipts (1a+2+3)	**2681360**	**3095233**	**3467663**	**3411853**	100.00	100.00	100.00	100.00	0.89

Source: Government of India (2021), (Basic Data), Union Budget documents

Economic Stimulus

The economic stimulus packages have two components. One focuses on measures that relate to instantaneous economic firefighting and the other pertains to long-term policy imperatives. On the monetary policy front, the Reserve Bank of India (RBI) has done the heavy lifting through five consecutive lowering of the repo rate adding to a total of 135 basis points from February to October 2019, along with liquidity infusion programmes (Thomas and Chakraborty 2021). However, the monetary-fiscal linkages are crucial to catalyse demand.

Stiglitz and Rashid (2020) pointed out that "today's excess liquidity may carry a high social cost. Beyond the usual fears about debt and inflation, there is also good reason to worry that the excess cash in banks will be funneled toward financial speculation," and they warned that this could lead to a "climate of increased (economic) uncertainty" and end up "discouraging both consumption and the investment needed to drive the recovery." This could lead us into a "liquidity trap" with a huge increase in the supply of money and not much to show for use of it by businesses and households (Chakraborty and Harikrishnan 2020).

In India, with a policy repo rate at 4%, the RBI has retained the status quo (RBI 2021). The Consumer Price Index (CPI) inflation, after crossing 7%, has led to a negative rate of interest in India. However, the CPI inflation has cooled off to 4.6% in December 2020. The New Monetary Framework (NMF)—the agreement between the RBI and the union government in February 2016 adopting inflation targeting—will be reviewed in March 2021. When monetary policy stance has limitations, through its liquidity infusion programmes and policy rate adjustments, in triggering growth, the fiscal dominance is crucial for economic recovery. The economies which rebounded fast, ex post global financial crisis, were the ones which resorted to significant fiscal stimulus.

In the Union Budget 2021, the fiscal stimulus was announced as "targeted" economic packages, especially in capital infrastructure investment. There is an increasing recognition of the fact that public investment has suffered from fiscal consolidation when the national and subnational governments have over-adjusted to the fiscal rules by capital expenditure compression. Empirical evidence suggest that public investment is one of the crucial determinants in strengthening private corporate investment in the context of emerging economies (Vinod et al 2020). Intertemporally, there is no financial crowding out through real interest rate mechanisms, as well (Chakraborty 2016).

The total size of the budget for FY2021 has increased to `34.50 lakh crore. In FY2022, total expenditure is pegged at `35 lakh crore. Out of total spending by the central government, 10% constitutes defence, while 23% constitutes interest payments (Table 4, p 22). The food subsidy is 12.25% of total central government revenue expenditure in 2021 RE, as compared to only 3.80% in 2020 BE. In agriculture, education, energy, and home affairs, the fiscal slippage numbers above one reveal that RE is less than BE. Intertemporally, the budget credibility analysis of macro-fiscal variables at national and subnational government levels revealed that the reasons for fiscal forecasting errors can be bias, variation or random (Chakraborty et al 2020).

Table 4: Anatomy of Revenue Expenditure

(In ₹ crore)					(in %)				
	2019-20	**2020-21**	**2020-21**	**2021-22**	**2019-20**	**2020-21**	**2020-21**	**2021-22**	**2020-21 BE/RE**
	Actuals	**Budget Estimates**	**Revised Estimates**	**Budget Estimates**	**Actuals**	**Budget Estimates**	**Revised Estimates**	**Budget Estimates**	**Fiscal Slippage**
Pension	183955	210682	204393	189328	6.85	6.93	5.92	5.44	1.03
Defence	318665	323053	343822	347088	**11.86**	**10.62**	**9.96**	**9.96**	0.94
Subsidy -					0.00	0.00	0.00	0.00	
Fertiliser	81124	71309	133947	79530	3.02	2.34	3.88	2.28	0.53
Food	108688	115570	422618	242836	4.05	3.80	12.25	6.97	0.27
Petroleum	38529	40915	38790	12995	1.43	1.34	1.12	0.37	1.05
Agriculture and Allied Activities	112452	154775	145355	148301	4.19	5.09	4.21	4.26	1.06
Commerce and Industry	27299	27227	23515	34623	1.02	0.89	0.68	0.99	1.16
Development of North East	2658	3049	1860	2658	0.10	0.10	0.05	0.08	1.64
Education	89437	99312	85089	93224	3.33	3.26	2.47	2.68	1.17
Energy	43542	42725	33440	42824	1.62	1.40	0.97	1.23	1.28
External Affairs	17246	17347	15000	18155	0.64	0.57	0.43	0.52	1.16
Finance	18535	41829	50566	91916	0.69	1.37	1.47	2.64	0.83
Health	63425	67484	82445	74602	2.36	2.22	2.39	2.14	0.82
Home Affairs	119850	114387	98106	113521	4.46	3.76	2.84	3.26	1.17
Interest	612070	708203	692900	809701	22.78	**23.28**	**20.08**	**23.25**	1.02
IT and Telecom	20597	59349	32178	53108	0.77	1.95	0.93	1.52	1.84
Others	79523	84256	94371	87528	2.96	2.77	2.74	2.51	0.89
Planning and Statistics	5479	6094	2164	2472	0.20	0.20	0.06	0.07	2.82
Rural Development	142384	144817	216342	194633	5.30	4.76	6.27	5.59	0.67

Scientific Departments	27367	30023	22352	30640	1.02	0.99	0.65	0.88	1.34
Social Welfare	44649	53876	39629	48460	1.66	1.77	1.15	1.39	1.36
Tax Administration	169331	152962	147728	131100	6.30	5.03	4.28	3.76	1.04
of which Transfer to GST Compensation Fund	153910	135368	106317	100000	5.73	4.45	3.08	2.87	1.27
Transfer to States	148907	200447	207001	293302	5.54	6.59	6.00	8.42	0.97
Transport	153437	169637	218622	233083	5.71	5.58	6.34	6.69	0.78
Union Territories	15128	52864	51282	53026	0.56	1.74	1.49	1.52	1.03
Urban Development	42054	50040	46791	54581	1.57	1.64	1.36	1.57	1.07
Grand Total	**2686330**	**3042230**	**3450305**	**3483236**	100.00	100.00	100.00	100.00	0.88

Source: Government of India (2021), (Basic Data), Union Budget documents

Intergovernmental Fiscal Transfers

The finance minister has announced a new centrally sponsored scheme (CSS) for enhancing public health infrastructure—Prime Minister Atma Nirbhar Swasth Bharat Yojana—with an outlay of `64,180 crore over the next six years. However, the finance minister has also announced a plausible convergence of CSS, as recommended by the Fifteenth Finance Commission report, which was tabled in Parliament on 1 February 2021. This transition in the structure of intergovernmental fiscal transfers from conditional grants to formula-based (tax transfers) unconditional transfers (which is 41% of tax pool as recommended by the Fifteenth Finance Commission) is welcome. The unconditional transfers provide greater fiscal autonomy to state governments. The disaggregate analysis also shows that there is no increased centralisation in the design of fiscal transfers in India with conditional grants constituting only 22.96% (BE 2021–22) of the total transfers in India.

As per the 2020–21 RE, the tax transfer share (41.86%), goods and services tax (GST) compensation (8.39%), finance commission grants, including the local body grants and revenue deficit grants (13.88%) and CSS (23.99%) are the significant components of intergovernmental fiscal transfers to the states in India (Table 5, p 23). The remaining 4% is the intergovernmental fiscal transfers to the union territories, including Delhi, Jammu and Kashmir and Puducherry.

Table 5: Intergovernmental Fiscal Transfers – Conditional and Unconditional

(In ₹ crore)				(in per cent)		
	2019-20 Actuals	**2020-21 Revised Estimates**	**2021-22 Budget Estimates**	**2019-20 Actuals**	**2020-21 Revised Estimates**	**2021-22 Budget Estimates**
I. Devolution of States share in taxes	**650678**	**549959**	**665563**	**56.80**	**41.86**	**47.93**
II. Some Important Items of Transfer	**53706**	**171873**	**90055**	**4.69**	**13.08**	**6.49**
1. Assistance to States from NDRF	18889	10000	12391	1.65	0.76	0.89
2. Back to Back Loans to States in lieu of GST Compensation Shortfall	-	110208	-		8.39	
3. Central Pool of Resources for North Eastern Region and Sikkim	380	200	405	0.03	0.02	0.03
4. Externally Added Projects – Grants	2702	2500	3000	0.24	0.19	0.22
5. Externally Aided Projects – Loan	24668	32025	46750	2.15	2.44	3.37
6. Schemes of North East Council	323	224	221	0.03	0.02	0.02
7. Schemes under Provision to Article 275(1) of the Constitution	2661	718	1119	0.23	0.05	0.08
8. Special Assistance as Loan to States for Capital Expenditure	-	12000	10000		0.91	0.72
9. Special Assistance under the demand - Transfers to States	1624	3000	15000	0.14	0.23	1.08
10. Special Central Assistance to Scheduled Castes under Demand - Department of Social Justice and Empowerment	1115	290	-	0.10	0.02	
11.Special Central Assistance to Tribal Area under the Demand - Ministry of Tribal Affairs	1346	708	1170	0.12	0.05	0.08
III. Finance Commission Grants	123710	182352	220843	**10.80**	**13.88**	**15.91**
1. Grant for local bodies - Urban Bodies	25098	25000	22114	2.19	1.90	1.59
2. Grant for local bodies - Rural Bodies	59361	60750	44901	5.18	4.62	3.23
3. Grants for Health Sector	-	-	13192			0.95
4. Grants-in-Aid for SDRF	10938	22262	22184	0.95	1.69	1.60
5. Post Devolution Revenue Deficit Grants	28314	74340	118452	2.47	5.66	8.53
IV. Total Transfer to States [Other than (I)+(II)+(III)]	**289233**	**358789**	**363355**	**25.25**	**27.31**	**26.17**
1. Under Centrally Sponsored Schemes (Revenue)	275428	315238	318857	24.04	23.99	22.96
2. Under Central Sector Schemes (Revenue)	12864	42374	43016	1.12	3.22	3.10
3. Under Other Categories of Expenditure (Revenue)	927	1049	1259	0.08	0.08	0.09
4. Capital Transfers	13	128	223	0.00	0.01	0.02
V. Total Transfer to Delhi, Puducherry and Jammu & Kashmir	**28161**	**50963**	**48686**	**2.46**	**3.88**	**3.51**
1. Under Centrally Sponsored Schemes (Revenue)	3578	6583	8065	0.31	0.50	0.58
2. Under Central Sector Schemes (Revenue)	218	1080	177	0.02	0.08	0.01
3. Under Other Categories of Expenditure (Revenue)	24140	43301	40444	2.11	3.30	2.91
4. Capital Transfers	225	-	-	0.02		
Total Transfer to States/UTs	**1145487**	**1313937**	**1388502**	100.00	100.00	100.00

Source: Government of India (2021), (Basic Data), Union Budget documents

Conclusions

In the time of macroeconomic uncertainty, high fiscal deficit announced in Union Budget 2021 can be growth-enhancing as it can catalyse public investment and reduce the output gap. The adherence to fiscal rules at 3 % of fiscal deficit—GDP ratio would have been detrimental to economic recovery, especially when the monetary policy stance has limitations in triggering growth through the liquidity infusion and the status quo policy rates. Hence, the "fiscal dominance" is crucial for sustained growth recovery.

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