Getting the fiscal story right

There is no 'one-size-fits-all' solution. The direction of consolidation, rather than a specific quantified path, is the most appropriate consideration during a pandemic

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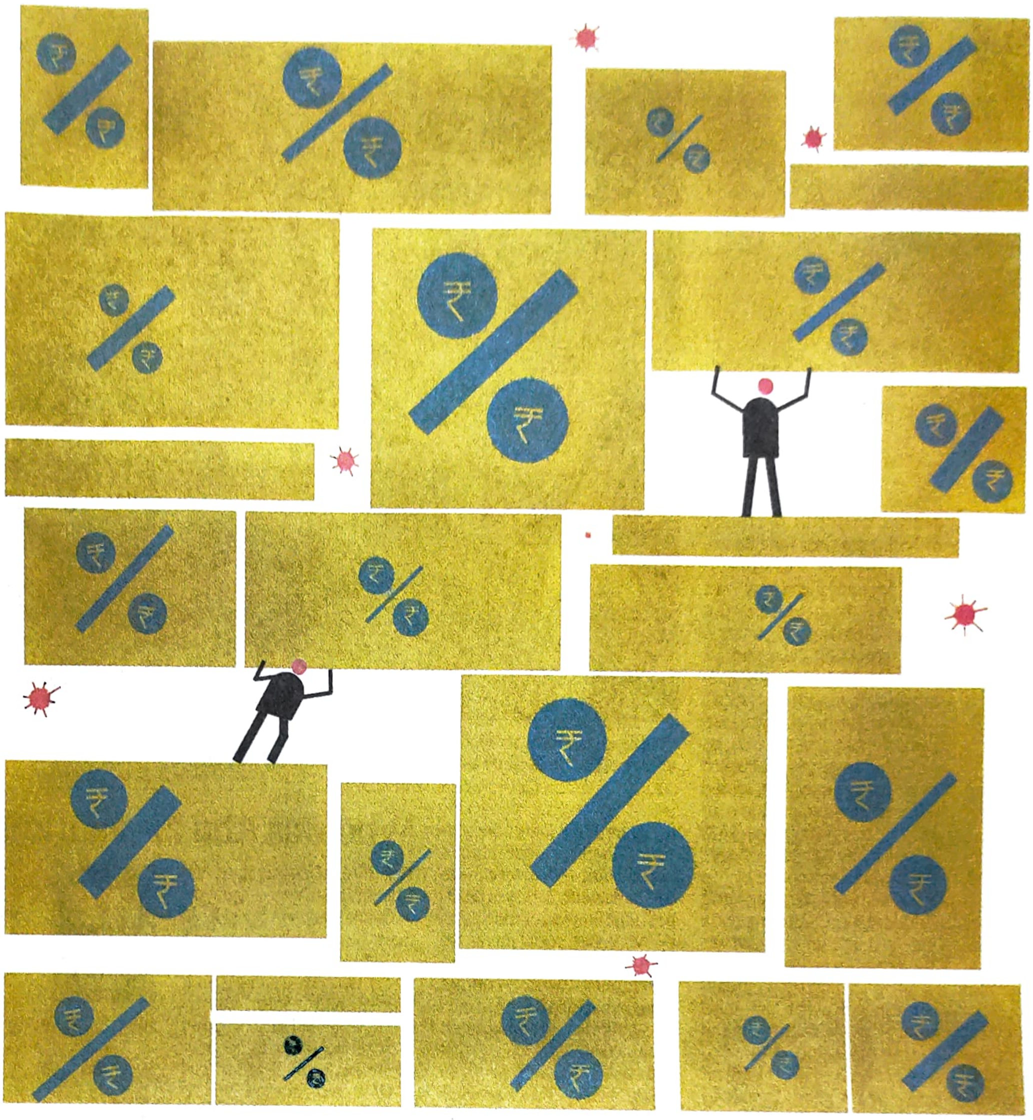

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THE UNION BUDGET 2022-23 indicates that the Covid-induced fiscal shock is much less pronounced now as compared to last year. We do not have a post-Covid medium-term growth projection for the country yet. However, if we take the Fifteenth Finance Commission's growth projection as a reference, India's actual growth performance for the fiscal years 2020-21 and 2021-22 was well above the projections made by the commission. For the fiscal year 2022-23, the economy is projected to grow at 11 per cent (at current prices) compared to 9.5 per cent projected by the Finance Commission. This improved growth performance is also reflected in higher revenue mobilisation, thus creating fiscal space for higher spending.

One of the highlights of the budget has been its focus on capital investment. However, financing for such capital investments has several dimensions. Given the economy's savings-investment profile and macroeconomic uncertainties due to the pandemic, private and household investments are likely to be reactive to the general economic environment and it is safe to assume that the decisions to save and invest may have been seriously impacted by the pandemic. But for the government, making capital investment in such uncertain times assumes a much higher priority and is equally indispensable for achieving a strong and sustainable recovery from the pandemic. Data available till 2019-20, as per National Accounts, shows that gross fixed capital formation by the general government (Centre and states) has shown an increase as a percentage of GDP from 3.48 in 2011-12 to 3.82 in 2019-20, while other sectors, particularly households, the share fell from 15.75 per cent to 11.39 per cent during the same period.

The fiscal stance taken in the post-pandemic budgets for higher capital spending, including the budget of 2022-23, is likely to further enhance the general government share in overall capital formation. This year's Union budget projects an increase in capex by Rs 3.14 lakh crore, as compared to the budgeted numbers of the previous fiscal. However, it is also important to recognise that two-thirds of the general government's capital expenditure is undertaken by states and in this context, the announcement of the Rs 1 lakh crore interest-free loans to the states to increase public investment has been a significant step. The 50-year interest-free loan to the states for the fiscal-year 2022-23 is important for two reasons: First, as it is meant for capital spending, it cannot be diverted to finance revenue deficit and thus has the potential to augment capital spending at the state level and thereby the overall capital spending in the country. Second, in the year 2021-22, 13 states had reported revenue deficit in their accounts and this loan facility (which is over and above the FRBM limit), can prevent the downside fiscal-risk of reduction in capital expenditure at the state level. Allocation priorities for this interest-free loan have also been indicated in the budget. One such priority is the states' share of the PMGSY contribution from this fund. Since states taken together have a higher share in the country's public capital spending, effective absorption of this additional borrowing facility will be critical for higher public investment.

On the fiscal consolidation story, there are three broad trends. First, the increase in taxes by Rs 5.71 lakh crore between 2020-21 (the first year of the pandemic) and 2022-23 shows that the fiscal challenges have eased, but remain present as we navigate economic recovery in uncertain times. Second, between 2020-21 and 2022-23 (BE), the reduction in revenue deficit has been substantial — from 7.3 per cent to 3.8 per cent of GDP. Third, compositionally, revenue deficit continues to be more than 55 per cent of the fiscal deficit and the management of such a deficit has few important considerations for revenue expenditure, that is, interest payments and allocation under various centrally sponsored and central sector schemes.

The change in allocation within the CSS basket receives a great deal of attention after every budget. However, the fundamental point is that resource flow to the states in the form of CSS is still substantial. Aggregate allocation under centrally sponsored and central sector schemes (CSS) as per the 2022-23 (BE) is Rs 3.83 lakh crore and the interest payment cost of the Union government is Rs 9.56 lakh crore. Beyond scheme-wise allocations, it is also important to consider CSS allocation as an issue of macro-fiscal management issue at the Union and state level, especially when it is contributing to the high revenue deficit of the central government and binding state resources for matching contribution, thereby increasing states' deficit.

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Overall, the fiscal deficit for the year 2022-23 is higher than what was recommended by the Fifteenth Finance Commission. However, if we consider the direction of consolidation, it is towards a reduction in the fiscal deficit. The post-Covid fiscal consolidation framework is evolving globally and there is pressure on governments to calibrate the deficit and debt in a way that responds to the crisis. Though in the medium-term, the fiscal story is about supporting recovery, it is also true that there is no "one-size-fits-all" solution to fiscal consolidation and debt sustainability. This remains the most complex part of fiscal management when one focuses on the budget of a single year. The direction of fiscal consolidation rather than a specific quantified path in an unprecedented time like this is probably the most appropriate consideration.

The writer is director, National Institute of Public Finance and Policy. Views are personal