# Budget must keep fiscal policy accommodative; consolidate without affecting recovery: NIPFP's Chakraborty

The Union government must keep the fiscal policy accommodative to support growth recovery amid an uncertain global situation and monetary tightening, according to Lekha S Chakraborty, a professor at the National Institute of Public Finance and Policy (NIPFP).

Finance minister Nirmala Sitharaman is scheduled to table her budget for FY24 on February 1 amid expectations that the fiscal deficit will be lowered from this year's targeted 6.4 percent of gross domestic product.

While the finance ministry has targeted lowering the budget deficit to below 4.5 percent of GDP by FY26, the path to that goal is not clear. The government must reconsider the 3 percent of GDP target under the fiscal rules, Chakraborty, who is also an elected member of the governing board of management at the International Institute of Public Finance, told *Moneycontrol* in an interview.

NIPFP is an autonomous research institute under the Ministry of Finance.

The budget should not focus on short-term benefits designed to win elections, Chakraborty said. Edited excerpts:

**The Centre's fiscal deficit has been brought down from over 9 percent in FY21. How difficult will it be to take the deficit to 4.5 percent by FY26?**

Geopolitical risks and uncertainties are high. The monetary policy stance is focusing on inflation containment by keeping the interest rate consistently high. So fiscal policy needs to remain accommodative. This requires a careful mapping of fiscal consolidation without affecting the growth recovery process. The route to fiscal consolidation through tax buoyancy than expenditure compression will be a relatively less painful path towards economic growth recovery.

**Has the central government's committed expenditure become too large to reduce? Debt has also ballooned as a percentage of GDP. Can the fiscal deficit and debt targets be met at all in the medium term?**

High public debt and deficit can be substantiated if it's used judiciously for capital infrastructure investment and also for reducing output gaps. However, high public debt cannot be used for fiscally profligate (measures), incentivising the calculus of consent, given the elections on the anvil.

A revision in the threshold ratio of the deficit envisaged in the existing fiscal rules at 3 percent needs urgent attention. If the 3 percent threshold norm affects capex formation – if the government over-adjusts to fiscal rules by reducing capex – the growth recovery process will be delayed.

**The government has often said its debt is sustainable because the nominal growth rate exceeds the rate of interest on public debt. Should we take comfort from this assessment?**

Of course, it is an unsustainable debt situation. Your question related to the stock of debt is important. However, if we can grow out of debt, meaning if the rate of economic growth is higher than cost of credit, we can enjoy a transitory fiscal space.

**The health of state finances became a matter of debate after comparisons were drawn with the Sri Lanka crisis. The issue of freebies added fuel to the fire. Have the states been more profligate in spending than the Centre?**

Cooperative federalism models require cordial Centre-state relations in the fiscal space. Volatility in fiscal transfers affects the fiscal space available to the finance ministers of state governments. The flexibility of use of subnational fiscal space is indeed significant. However, the articulation of fiscal space for designing the programmes is crucial.

The term freebies is eclectic and we need a high-level panel debate on what exactly is termed as 'freebies.' The Sri Lankan situation of unsustainable debt won't be replicated in India as ours is a more diverse economy and the proportion of external debt financing is negligible.

**Questions have been raised about the Centre's control over state finances – how much they can borrow or repeated demands to cut taxes such as those on fuel. The introduction of GST further constrained the states' ability to raise revenue. Are states not in control of their fortunes?**

Of course, the state's fiscal space is determined both by intergovernmental fiscal transfers and 'own' revenue. Given the uncertainties in revenue buoyancy due to exogenous factors like supply-chain disruptions, energy price volatility, global inflation, tax buoyancy may get affected. The macroeconomic stabilisation can be better done at the Central government level. However, now states are equally exposed to global macroeconomic uncertainties. That is indeed a matter of concern.

**The Centre has tried to help the states by providing long-term, interest-free capex loans and releasing extra instalments of tax devolution. Are these two measures enough to cultivate growth?**

The heavy lifting of capex investment is happening at the state level. Therefore, it is crucial to provide the states long-term interest-free loans. This decision by the Central government is adorable. The capex is a simultaneous decision by the states and the Centre, which is crucial for growth. Otherwise, states will try to maintain their expenditure within the stipulated fiscal rules at the cost of capex.

**The Centre's capex is dominated by railways, roads, and defence. The pandemic led to calls for more to be spent on health and education. Are there other areas in equally pressing need of investment?**

Social infrastructure investment in health and education is crucial. In the post-pandemic fiscal strategy, assuming that 'revenue expenditure is bad' is a misnomer. Within revenue expenditure, a careful reprioritisation is required to avoid fiscal profligacy and to focus on 'lifeline infrastructure' - both social and physical infrastructure.

**Private capex has been subdued for several years. Given the current capacity utilisation levels, the weakening outlook for external demand, and rising interest rates, could the government's efforts to crowd-in the private sector prove futile?**

Yes, public investment (capex) is an important determinant to crowd-in private corporate investment. However, the effect is not instantaneous. Continued capex by the government is required for the private sector to tackle the exogenous risks you mentioned, including rising interest rates and sluggish demand.

The Reserve Bank of India should give liquidity guidance – through targeted credit infusion – as interest rates are rigid upwards to tackle flighty capital (FPI outflows) and mounting inflation.

**Has the government's outsized market borrowing programme also impacted monetary policy? The RBI increased the repo rate sharply in 2022, but in 2021, it repeatedly said the yield curve was a public good even in the face of above-target inflation.**

Yes, there is a conflict of interest over there in the RBI's decision. The decision to raise interest rates was crucial for tackling mounting inflation, flighty capital and financial savings (our interest rates are negative). However, high interest rates affect public debt management as the cost of borrowing is going high. The term structure of interest rates (the relationship between short and long interest rates), the monetary policy transmission mechanism and the 'interest rate spreads' are crucial.

The only way out here is to simultaneously buy and sell bonds – buy more long-term and sell more short-term – so that the maturity structure of the debt market can be elongated for creating the space for a robust economic growth recovery with less immediate refinancing risks.

**Numerous forces are at play: slowing growth, easing but still high inflation, external weakness, and state elections in 2023 and the general election in 2024. What are the areas the budget should not compromise on?**

The budget should not focus on short-term benefits by designing programmes to incentivise the calculus of consent of voters to win elections. The government should avoid clientele-based public expenditure decisions to win elections. Long-term growth trajectory and sustained human development process are crucial and in retrospect that has gained the voter's mandate.