A chance to support growth, fiscal consolidation

Two years of real growth in economic activities have been wiped out by COVID-19, which the Budget must take note of

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The National Statistical Office (NSO) released the first advance national accounts estimates for 2021-22 on January 7, 2022. India's real GDP growth in 2021-22 is estimated at 9.2%, that is 30 basis points lower than the projection by the Reserve Bank of India and the International Monetary Fund (IMF) projection of 9.5%. In an earlier analysis (*The Hindu*, December 18, 2021, "The challenge of achieving 9.5% growth rate"), we had considered some of the ongoing challenges to the 2021-22 growth forecast, indicating a possible decline. The adverse effect of the third wave of COVID-19, which is mainly affecting the last quarter of 2021-22, may call for a further downward adjustment in the growth rate to about 9%. The main sectors that have held back a more robust recovery are trade, transport, *et al*. on the output side and private final consumption expenditure (PFCE) on the demand side as their annual estimated 2021-22 magnitudes remain below the corresponding levels in 2019-20.

Growth prospects

With respect to the prospects of 2022-23 growth, IMF and Organisation for Economic Co-operation and Development (OECD) forecasts have indicated growth rates at 8.5% and 8.1%, respectively. However, these may prove to be optimistic as the base effects characterising 2021-22 may be limited. In fact, as per the NSO's advance estimates, at the end of 2021-22, the magnitude of GDP in real terms is estimated at INR₹147.5-lakh crore that is only a shade higher than INR₹145.7-lakh crore in 2019-20. Thus, due to the three waves of COVID-19 that India has experienced, two years of real growth in economic activities have been wiped out. The economy has to now start on a clean slate. Growth in 2022-23 would depend on the basic determinants such as the saving and investment rates in the economy. As per the advance estimates, the gross fixed capital formation (GFCF) relative to GDP at current prices stands at 29.6% in 2021-22. Capacity utilisation in India continues to have considerable slack. Available quarterly data indicate a capacity utilisation ratio of only 60% at the end of the first quarter of 2021-22 and an average of 61.7% in the preceding four quarters. As such, a pick-up in private investment may take some time.

Private final consumption expenditure (PFCE) also shows a low growth of 6.9% in 2021-22. Any pick-up in demand would continue to be constrained by low-income growth in sectors characterised by a high marginal propensity to consume (MPC) such as the trade, transport, *et al*. sector and the Micro, Small and Medium Enterprise (MSME) sector more broadly. Growth in 2022-23 would also continue to be constrained by supply-side bottlenecks and high prices of global crude and primary products. It may thus be prudent to expect a real GDP growth in the range of 6%-7%. The implicit price deflator (IPD)-based inflation which was as high as 7.7% in 2021-22, may come down to about 5%-6%. Thus, we may expect a nominal GDP growth of about 12%-13% in 2022-23. It is the nominal magnitude which is crucial as far as the Budget is concerned.

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It was due to the high IPD-based inflation that the nominal GDP growth in 2021-22 at 17.6% exceeded real GDP growth by a margin of 8.4% points. This high nominal growth combined with base effects resulted in the Centre's gross tax revenue (GTR) growth of 50.3% during the first eight months of the current fiscal year. In the first six months of 2021-22, this growth was even higher at 64.2%. In October and November 2021, the average growth in the Centre's GTR fell to about 17.4% as the base effect was weakening. We assess that the annual growth in the Centre's GTR may be close to 35%, implying a buoyancy of nearly 2. With these buoyant tax revenues, the Government may be able to limit the 2021-22 fiscal deficit to its budgeted level of 6.8% of GDP although a marginal slippage may not be ruled out. There may be some slippage in disinvestment targets and supplementary expenditure demands have also to be accommodated.

Going forward, since the base effects in the Centre's GTR would have weakened, we may expect a lower annual GTR growth of about 15%-16% in 2022-23 which in combination with a nominal GDP growth of 13% implies a buoyancy of about 1.2. This would still compare well with the Centre's GTR growth performance in the pre-COVID-19 years which averaged only 5.6% during 2017-18 to 2019-20. The major corporate income tax (CIT) reform undertaken in 2019-20 had provided, among other things, a concessional CIT rate of 15% for fresh investment in manufacturing by domestic companies provided their production took off on or before March 31, 2023. As nearly two years have been lost due to COVID-19, the Government may consider extending the time limit for availing this benefit. The GST compensation provision would also come to an end in June 2022. This would cause a major revenue shock at least for some States such as Tamil Nadu, Kerala and Andhra Pradesh. While this matter may be considered by the GST Council, the compensation arrangement should be extended by two years in some modified form. Its impact on the Centre's Budget should be provided for.

With respect to non-tax receipts, the scope of the National Monetization Pipeline (NMP) may be extended to cover monetisation of government-owned land assets. Disinvestment initiatives may have to be accelerated.

Expenditure priorities

Expenditure prioritisation in 2022-23 should focus on reviving both consumption and investment demand. The National Infrastructure Pipeline (NIP) should be reassessed, and its path may be recast in order to make up for existing deficiencies in relation to the original targets – particularly in the health sector. In this regard, the infrastructure investment undertaken by State governments and the public sector should be realistically ascertained and shortfalls with respect to original targets may be identified and remedial measures initiated. Since consumption demand remains weak, some fiscal support in the form of an urban counterpart to Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) may be considered in addition to supporting some of the sectors which are directly impacted by COVID-19. Revival of the economy in 2022-23 would critically depend on containing the adverse economic impact of the third wave of COVID-19 – and subsequent waves – to a minimum.

Return to fiscal consolidation

It would be appropriate now to consider a graduated return to fiscal consolidation while using fiscal policy to lay the base for faster growth in the years to come. The Fifteenth Finance Commission had suggested a fiscal consolidation path where the Centre's fiscal deficit was benchmarked at 5.5% of GDP for 2022-23. In their pessimistic scenario, it was kept at 6% of GDP. At this point, while supporting growth is critical, signalling a return to fiscal consolidation is also important. It may be prudent to limit the reduction in fiscal deficit-GDP ratio to about 1% point of GDP in 2022-23. This would imply a fiscal deficit in the range of 5.5%-6% of GDP. From here on, a stepwise reduction of 0.5% points per year would enable a level of about 4% of GDP by 2025-26. By this time, as suggested by the Fifteenth Finance Commission, a high-powered inter-governmental group should be constituted to re-examine the sustainability parameters of debt and fiscal deficit of the central and State governments in the light of new empirical realities, particularly taking into account the likely level of interest rate on government debt.

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