Fiscal consolidation in the context of the Budget

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The Budget for 2023-24 has attempted to address the aspirations of different segments of society. It is a good effort in a difficult situation. But how far do the Budget provisions go to meet the two fundamental goals of growth and stability? The two must go together for sustained growth over the medium term, which will be the answer to many of India's socioeconomic problems.

Budgetary support to growth

Growth is affected by the size of government expenditure and its revenue and capital components. Government expenditure is budgeted to grow at 7.5% while nominal GDP growth is estimated to fall from 15.4% in 2022-23 to 10.5% in 2023-24. Thus, the total expenditure relative to GDP is shown to fall from 15.3% in 2022-23 (RE) to 14.9% in 2023-24 (BE). The composition of government expenditure, however, would be growth positive.

Increase in the Centre's capital expenditure is budgeted at 37% while that in revenue expenditure is only 1.2%. According to estimates by the Reserve Bank of India (2019, 2020), the multiplier associated with central government capital expenditure is 2.45, while that for revenue expenditure is 0.45. Investment expenditure by central public sector undertakings (PSUs) is budgeted to fall by 0.2% points.

However, State capital expenditures may increase as a result of central grants to the States meant for capital asset creation amounting to 1.2% of GDP, augmentation of States' fiscal deficit to GDP ratio to 3.5%, and the facility of 50 years of interest-free loans for creating capital assets in 2023-24.

It is difficult to ascertain the extent to which States might utilise these facilities. Growth may also be stimulated indirectly due to an increase in private disposable incomes following tax slab adjustments applicable to the new income tax regime. Real growth in 2023-24 may be a little above 6%.

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A stronger fiscal consolidation road map is needed over the medium term

External conditions as reason

According to the Fiscal Responsibility and Budget Management (FRBM) Act, as amended in 2018, the Centre is mandated to take appropriate steps to limit its fiscal deficit to 3% of GDP by March 31, 2021 although this is an operational target. The mandated target pertains to the Centre's debt-GDP ratio which is to be brought down to 40%. If there is a deviation from the fiscal deficit-GDP ratio of 3%, the Centre is required to state the reasons. In the medium-term fiscal policy cum Fiscal Policy Strategy Statement (MTFP), the Centre has attributed the deviation of the budgeted 5.9% fiscal deficit-GDP ratio to external economic conditions. For this reason, the Centre has also not provided the medium-term GDP growth forecasts.

Furthermore, the Centre has also not indicated the year by which it envisages reaching a fiscal deficit level of 3% of GDP. Instead, it has indicated that a level of 4.5% of GDP would be reached by 2025-26, calling for a steeper adjustment of 0.7% points each in the next two years. It might require another two to three years for reaching a level of 3%. However, even by this time, the mandated debt-GDP ratio of 40% would not be reached. The Centre's debt-GDP level net of liabilities on account of investment in special securities of states under the National Social Security Fund (NSSF), is budgeted to increase from 55.7% in 2022-23 (RE) to 56.1% in 2023-24 (BE). This increase is expected as the primary deficit to GDP ratio is indicated at 2.3% in 2023-24.

The MTFP statement does not indicate the year by which the government aims to reach the mandated debt-GDP target of 40%. One implication of the high level of Centre's debt-GDP ratio is for interest payments relative to revenue receipts, which is budgeted at 41% in 2023-24. This reduces, significantly, the space for primary expenditure in the Centre's budget.

Private investment

For raising growth in the medium term, augmentation of private investment relative to GDP needs to be ensured. This requires that enough investible resources are left for the private sector after the public sector's pre-emptive claim on these resources. At present, total investible resources, consisting of financial savings of the household sector amounting to about 8% of GDP and net foreign capital inflows amounting to 2.5% of GDP, may be estimated at 10.5% of GDP. The central and State fiscal deficits considered together may amount to 9.4% of GDP in 2023-24. This implies that only 1.1% is available for the private sector and the non-government public sector.

Investment of the Centre's PSUs themselves amount to 1.1% of GDP in 2023-24, leaving little scope for State PSUs and the private sector. This is not amenable to creating an environment for interest rate reduction. In fact, trying to borrow beyond the available investible resources by the government can only lead to inflation. We know the dilemma faced by the government. Any further reduction in the fiscal deficit will cut expenditures which may not be appreciated. We need, however, a stronger fiscal consolidation road map over the medium term.

The views expressed are personal