Balance fiscal consolidation with growth

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As the number of COVID-19 cases subsided, 2022-23 was expected to be a normal year. However, this hope was shattered by Russia's invasion of Ukraine. The supply of critical imports was disrupted and, as a consequence, the prices of such imports increased sharply, derailing many economies. Growth slowed down, and India was affected too. While India's performance was relatively better than many other countries, the return to normalcy has been delayed. Even at the currently projected growth rate, India's GDP at the end of the present fiscal year will only be 8.57% higher than its level in 2019-20, giving an average of 2.86% for three years. India needs to move on to a high growth path beginning 2023-24. In this context, what should be the focus of the upcoming Budget to achieve steady, high growth with reasonable price stability?

Growth performance

In 2022-23, real Gross Value Added (GVA) is estimated to grow by 6.7%. Its sectoral decomposition indicates that every output sector has turned positive as compared to the corresponding magnitudes in the pre-COVID-19 year of 2019-20. In other words, the 2023-24 Budget would pertain to the first normalised economy after the pandemic shock. The expectation is that nominal GDP in 2023-24 may be close to ₹300 lakh crore. This is based on applying a nominal growth of about 11-11.5%, which implies the assumption of a real growth in the range of 6-6.5% and a deflator-based inflation in the range of 4.5-5%. It may be noted that real growth in the second half of 2022-23 is only 5.5% as per the advance estimates.

The policy response to the COVID-19 shock, which affected 2020-21, was a sharp increase in the Centre's fiscal deficit to 9.2% of the GDP. This was more than three times the original Fiscal Responsibility and Budget Management Act (FRBM) norm of 3%. In the two succeeding years, fiscal deficit could be reduced to 6.7% and 6.4%, respectively. With 2023-24 being the first genuine post COVID-19 normal year, it would be best to spell out a convincing path towards the prescribed fiscal deficit ratio of 3%. This calls for a total adjustment of 3.4 percentage points of GDP. Given this task, a reduction of at least 0.7 percentage points may be targeted for 2023-24.

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There is, however, a need to recognise the challenges to India's growth prospects in view of the global economic slowdown. Multilateral institutions have projected global growth prospects and India's growth prospects for 2023-24. The Organization for Economic Co-operation and Development has projected a growth rate of 2.2% for the global economy in 2023 and 5.7% for India in 2023-24. The International Monetary Fund, on the other hand, has projected global growth at 2.7% and India's growth at 6.1%. India may be able to achieve a growth in the range of 6-6.5% in 2023-24, provided significant policy support is given to growth.

Saving-investment balance

The need for correction in the government's fiscal deficit primarily arises because of the relative profile of savings and investment as a proportion of GDP. Financial savings along with net inflow of foreign capital provide the extent of surplus available for the potential net deficit sectors in the economy, which consists of the public sector (government and non-government) and the private sector. Financial savings in the household sector had averaged 7.9% of GDP from 2017-18 to 2019-20 before it increased inordinately to 11.6% in 2020-21 due to an upsurge in the precautionary motive in the COVID-19 year.

If we target a reduction of 0.7% point in fiscal deficit in 2023-24 as compared to 2022-23, the resultant fiscal deficit of 5.7% of GDP would imply availability of investible resources of 1.1% of GDP for both the private corporate sector and the non-government public sector. This can be financed by a household sector financial saving of about 8% of GDP and net inflow of foreign capital of 2.3% of the GDP assuming that States are allowed a fiscal deficit of 3.5% of the GDP in 2023-24. This balancing would not put any additional pressure on interest rates and would be ideal for sustaining a robust medium-term growth with price stability. Bringing down fiscal deficit and charting out a glide path are essential for maintaining price stability. The pressure on the Reserve Bank of India (RBI) to expand reserve money will come down.

Fiscal prospects

We expect that growth in the Centre's Gross Tax Revenues (GTR) in 2023-24 would be less than that in 2022-23. This is because of an expected fall in both real GDP growth and deflator-based inflation. Assuming a nominal growth of about 11.5% and a buoyancy of 1 in 2023-24, the Centre's GTR may be estimated at ₹34.8 lakh crore while its net tax revenue would amount to ₹24.4 lakh crore. Together with non-tax revenues and non-debt capital receipts, total resources available to the Central government would be nearly ₹28.3 lakh crore. If a fiscal deficit of 5.7% of GDP is added, total expenditure may have to be limited to ₹45.7 lakh crore. This is only about 6.3% higher than the estimated total expenditure for 2022-23.

Fiscal support to growth would call for continuing emphasis on capital expenditure. A careful calibration would be required for limiting revenue expenditure growth in order to retain space for capital expenditure to grow adequately with a view to supporting growth.

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