Fiscal Deficit: Way Forward

R.Dinesh
President
Confederation of Indian Industry

The momentous performance of the Indian economy in recent times has rekindled dreams – and aspirations- of the country emerging as a developed economy in the near future. It is well recognised that to bring this dream to fruition, it is important that the economy continues the high and resilient growth path in the years ahead as well.

Nevertheless, the Indian economy is being buffeted by many challenges, both domestic and global. Softening global growth is already impacting the country in terms of faltering exports and slowing FDI flows. At the same time, in the domestic arena, subdued consumption demand is a concern. Besides, the prospect of the El Nino phenomenon on the monsoon performance and agriculture output could be a major pain point which could dent India's growth prospects in the present fiscal. Keeping these factors in mind, the IMF has marked down India's estimated growth rate to 5.9 per cent for FY24. The Reserve Bank of India (RBI) expects that robust macroeconomic fundamentals would help India to achieve a 6.5 per cent growth during the current fiscal year.

Amidst an uncertain economic milieu, a focus on prudent fiscal management can be a priority for higher growth rates going forward. A healthy fiscal balance provides the requisite resources to rejuvenate demand, fortify India's economic resilience, strengthen growth drivers, provide macroeconomic stability, and help the country to reach its goal of becoming a major economic power in times ahead. At the same time, adherence to fiscal deficit should not come at the cost of curtailing growth, which is India's primary economic objective.

The economic travails of recent years arising from the pandemic have demanded enhanced fiscal support in all economies. Unlike the advanced economies, India maintained a prudent stance and avoided a bloating Government expenditure, which in turn, helped its macroeconomic stability in the post-pandemic scenario. At a time when unprecedented inflationary conditions necessitated significant monetary tightening in many large economies, India has been able to manage its price rise and keep its fiscal targets well in sight, while at the same time ensuring that domestic demand did not collapse and infrastructure construction was escalated through a spike in public capital expenditure. This astute management of macroeconomic conditions helped impart strength to growth forces.

The Government well recognizes the need to maintain fiscal discipline and to continue on the path of fiscal consolidation. This has been evident from the Union Budget 2023-24 where the Government has adhered to its fiscal deficit target of 6.4% of GDP for FY23 to promote resilience and macroeconomic stability. The fiscal deficit is also slated to be reduced to 5.9% in FY24, thereby signaling the Government's strong commitment to continue the path of fiscal prudence. Once economic recovery strengthens, the Government may go for a large fiscal consolidation of about 1.5 percentage point over FY25 and FY26 to meet its medium-term fiscal deficit target of 4.5% by FY26.

The tight leash maintained by the Government to ensure that its finances are in good shape is reflected in the recent fiscal performance indicators. Accordingly, the latest data print released by the Controller General of Accounts (CGA) indicates that India's fiscal deficit for April- May 2023 stood at Rs. 2.10 lakh crore, or 11.8% of budget estimates as against 12.3% reported in the comparable period last year.

At the same time, total expenditure touched a lower 13.9% of the budget target in the first two months of this fiscal as against 14.8% in the same period of the last fiscal. This reinforces the perception that the Government is reining in its spending to ensure that the fiscal deficit target is met.

Further, there are reports that the Government is unlikely to increase its market borrowing plans for FY24. This also indicates that the deficit target will be met.

Given the expected global slowdown conditions and consequent pressure on India's growth rate, it is important that the Government continues to achieve the fiscal deficit target announced for the year. Slower growth is anticipated to impact tax collections resulting in lower fiscal resources to support the economy. The latest data reading indicates a contraction of 9.6% in tax revenues in April-May 2023. Besides, total receipts stood at 15.3% of budget estimates in April-May 2023 as against 16.7% in April-May 2022. Further, the Government also has to contend with the trending down of the inflation trajectory which would pull down nominal GDP growth and thereby raise the fiscal deficit.

Against this backdrop, a few broad suggestions which would help in meeting fiscal consolidation imperatives amid mounting external headwinds could be considered.

First, the emphasis should be on amplifying efforts to maximize revenue from non-tax sources. This would mean making renewed efforts to achieve the targets set under disinvestment, asset monetization, and diluting stakes in public sector banks, among others.

The Government should fast-track disinvestment of public sector units and meet the revenue target of Rs. 51,000 crore for the current fiscal. This is necessary and imminently possible as the capital market is presently booming. Such a move would help unlock the capital to garner resources for meeting the developmental priorities of the country and assist in capital formation. Further, the responsibility and authority for disinvestment of PSEs should be transferred to the Department of Investment and Public Asset Management (DIPAM) from the line Ministries once a decision has been taken to privatise these companies.

The Government should also complete the privatization of two public sector banks and one government-owned insurance company as announced in the Union Budget 2021-22 by making changes in the Banking Regulation Act.

Monetising idle government assets is yet another avenue for garnering non-tax revenues which can be used for capital creation. The National Monetisation Pipeline (NMP) is a commendable initiative by the Government seeking to monetise brownfield public assets by attracting private capital. In this context, meeting the target of Rs. 1.79 lakh crore worth of asset monetization set for 2023-24 by NITI Aayog should be a priority to unlock capital for productive use. For scaling up asset monetization, the Government should contemplate preparing an institutional backbone wherein each ministry must form an empowered working group to identify assets, suggest methods of monetisation, and assist in such transactions.

Secondly, apart from exploring options for augmenting non-tax revenues, there are possibilities of raising additional resources from tax collections even in a slowing economy by broadening the tax base. In fact, according to the 15th Finance Commission's estimates, there is over a 4% gap in tax to GDP ratio between India's tax collection potential and actual collections. The Government can aim to reach a 16% tax-to-GDP ratio over the medium term from the current level of around 12%.

For this, the Government should avoid large increases in income tax thresholds. This would allow for a broadening of the income tax base further. In addition, given most tax filers are in the INR 2.4 lakh to INR 5 lakh bracket, which includes many proprietorships and partnerships in the unorganized sector, the Government should track their incomes and operations effectively to curb tax evasion.

Further, it is important to rationalize multiple GST rates into a simple three-rate GST structure: low (for essentials), standard (for most of the products) and high (for demerit and luxury goods) and lower the peak rate of 28%. This will help boost tax buoyancy and improve tax compliance. Moreover, the Government should consider bringing electricity tariffs, petroleum products and real estate under GST at some stage over the medium term.

Additionally, steps towards improving the tax administration can increase tax compliance and collections. This involves better coordination and improvement in information sharing between the board of direct and indirect taxes. A faster appeal process for tax disputes will also help, as appeals against an income tax department enquiry involve multiple stages compared to one or two stages in many other countries.

Third, expenditure rationalisation would act to free funds available for investment. For this, non-merit subsidies should be rationalised. It is estimated that non-merit subsidies comprise a staggering 5.7% of GDP, of which 1.6% is from the Centre and 4.1% from the states. This is clearly unsustainable.

The Aadhaar-enabled direct benefit transfer for food and fertilizers should be continued so that the subsidy is delivered directly to farmers. Similarly, for fertilizers, urea price decontrol should be contemplated by either fixing a nutrient-based subsidy (NBS) rate or making direct payment of subsidy to farmers' account. AI related farmer solutions and promotion of millets can be steps to reduce the fertilizer subsidy bill over the medium-term.

Similarly, at this juncture, introducing any new subsidy scheme, apart from PLI, should be avoided unless it is an absolute imperative justified by social and economic considerations. A new subsidy scheme would necessitate substantial outgo of revenue expenditure and put further pressure on fiscal deficit. It is also expected that the Government would avoid the temptation of unproductive revenue expenditure in the election year, given its pledge to reduce the fiscal deficit.

The Government should also consider the suggestion made by the Fifteenth Finance Commission and cease funding of Centrally Sponsored Schemes where allocation is small, below a certain threshold. Similar schemes, wherever existing, should be merged and brought under a single umbrella. Further, states can be encouraged to provide for utilities, without affecting the fiscal situation.

Fourth, the Government has made commendable initiatives during the last three years to boost capital expenditure to revive the economy from the pandemic-induced slowdown and the subsequent geo-economic crisis. This has had a huge positive impact on the economy with gross fixed capital formation having increased by 11.4% for FY23. The Government should continue to focus on augmenting capital expenditure plans to kick-start the virtuous cycle of investment and growth.

Besides, the targets under National Infrastructure Pipeline and Gati Shakti should be completed on time. Such large-scale spending can help attract investments down the supply chain, including from small and medium enterprises.

Fifth, India could also consider setting up an independent fiscal council for strengthening the fiscal responsibility framework, as suggested by the IMF, going forward. Over the medium term, the Government should aim to move to a position where current spending matches current revenues— the golden rule of fiscal policy with a zero-revenue deficit.

Given that macroeconomic factors play a strong role in boosting investor sentiments, fiscal deficit is an important indicator to be addressed. However, it is also true that public expenditure can support the economy in times of global downturn and the present focus on enhancing capital expenditure for infrastructure is welcome. Ensuring adequate availability of funding for micro, small and medium enterprises would also ensure that jobs and livelihoods are protected.

To conclude, a deft handling of finances in a difficult year with a focus on reviving demand and boosting economic growth is crucial to navigate the economy through this difficult year and the Government is well prepared to adhere to this imperative.