Fiscal Restraint Trumps Fiscal Stimulus

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The 2020 Union Budget has failed to provide any fiscal stimulus based upon the assumption that there is no fiscal space for providing growth stimulus. In doing so, it missed out on the opportunity of leveraging an additional fiscal space of around 10% of the gross domestic product that could have been tapped through revenue and expenditure rationalisation measures.

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The 2020–21 Union Budget was expected to provide a strong fiscal stimulus to revive faltering economic growth. Those expectations have been belied. The revenue projections, though still overly optimistic, are more realistic than the revenue projections of the past two years. But, in aligning expenditure plans to these revenue projections, without any effort to mobilise additional revenues, this budget has failed to provide the required fiscal stimulus. In the sections that follow, we discuss in sequence the fiscal stance of the budget, its revenue measures, expenditure allocations and missed opportunities that the budget could have addressed to revive growth.

Growth Revival and Fiscal Dominance

Taking advantage of the low inflation environment, the Reserve Bank of India (RBI) repeatedly lowered the repo rate since February 2019 in an effort to bring down the structure of lending rates, and finally announced a pause in December 2019 as inflation rose. It also undertook open market operations and other monetary measures to stimulate investment and growth. However, these monetary policy measures have proved to be ineffective. Transmission has been weak, with little decline in the weighted average lending rate on fresh loans, and the spread between the policy rate and the benchmark 10-year g-sec rate remaining elevated at 171 basis points. Credit growth has declined in all categories, except personal loans. Meanwhile, the growth in investment expenditure has declined sharply, and so has growth.

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That monetary policy has failed to revive the investment and growth cycle is not really surprising, given the strong fiscal dominance of the financial sector. Large-scale sovereign borrowings by the central and state governments at relatively high, riskless rates set a high threshold for lending rates for the private sector. Fiscal dominance, in fact, extends well beyond the government's market borrowing to include high rates on National Small Savings Fund, government provident fund deposits, etc. Further, government-owned banks and non-bank financial institutions dominate the financial market. In this fiscally dominated environment, outcomes even in the financial sector, the core domain of monetary policy, are driven by fiscal policy. Hence, it is fiscal policy that has to do most of the heavy lifting for reviving growth. The macroeconomic stance of the 2020–21 budget has to be assessed against this background.

There is a wide consensus that the sharp decline in growth is largely attributable to weak aggregate demand. Hence, growth revival requires a strong public expenditure push. However, an expenditure push does not necessarily have to be financed by a larger deficit. It can be financed through additional revenue mobilisation, tax policy measures as well as additional non-tax revenues through asset sales to finance capital expenditure. The expansionary impact of increased central government expenditure can vary depending on how it is financed and also on how the expenditure is structured. This is because the multiplier effect of tax-financed spending is weaker than the expenditure financed by non-tax revenues, asset sales or a larger deficit. Similarly, the expansionary impact of capital expenditure is higher than that of revenue expenditure (Mundle et al 2011). Mundle and Sikdar (2020) have also argued that the multiplier effect of income support for the poor is stronger than that of other forms of revenue expenditure.

However, it turns out that the sources of financing central government expenditures have been fairly stable. Total expenditure, amounting to about 15% of the gross domestic product (GDP), has been more or less evenly financed by tax revenue and the other sources taken together (Table 1).[1] The structure of spending has also been fairly stable. Hence, the growth impact of central government expenditure has primarily depended on how it has increased, and not so much on its financing or its composition.

Total expenditure in 2020–21 (budget estimate or BE) is expected to grow by 9.2%, compared to 14.7% in 2019–20. This deceleration of expenditure growth entails a weakening of the fiscal impulse. Even the 14.7% growth in central expenditure in 2019–20 failed to arrest declining growth. Hence, the weaker fiscal impulse this year is unlikely to revive growth. In the absence of a strong fiscal stimulus, we can expect to see yet another year of low GDP growth, unless there is strong growth in other components of aggregate demand.

A comment is needed here on the issue of reforms versus fiscal stimulus. Reforms are important for sustaining high growth, but it takes time for their growth effects to play out. A fiscal stimulus can revive growth in the short term, thereby buying the time required for reforms to take effect over the medium to long term. Fiscal stimulation and reforms, therefore, are complementary policies and not competing alternatives.

Revenues and Receipts

On the revenue side of the budget, one of the two most significant developments in direct taxes is the conditional reduction in the corporate tax rate. While in December 2019, the corporate tax rate was reduced from 30% to 22% for existing companies and 25% to 20% for new manufacturing companies, the current budget has now extended the reduction to new service companies. The other is the introduction of a similar conditional, graded reduction in income tax rates for taxable income up to ₹15 lakh. The condition to become eligible for these lower rates is that the tax payee must forgo all exemptions and concessions.

The move to eliminate exemptions and concessions is most welcome at first glance. The government, at last, seems to want to plug the huge revenue loss on account of these exemptions and concessions. However, in linking the elimination of exemptions and concessions to lower tax rates and providing this as an option instead of mandating it, the government has left taxpayers the option of staying with the old rates along with concessions and exemptions. Taxpayers will obviously choose the regime that minimises their tax liability, resulting in significant revenue loss to the government. The government appears keen to reduce the tax liability of taxpayers rather than its own revenue loss. Given the large shortfall in tax revenue in 2019–20 (revised estimate or RE) compared to BE, and the government's own assessment of revenue forgone in 2020–21, it is curious how it has projected direct taxes to grow by 12.7% in 2020–21, when it grew by only 2.9% in 2019–20 (Table 2, p 21).

Indirect taxes are also projected to grow by 11.1% as compared to only 5.3% last year. This optimism is presumably on account of the goods and services tax (GST), which grew by 12.3% last year, despite all its implementation problems.

Table 1: Receipts, Expenditure and Deficits

		₹ Crore					% Change			
		2017–18 (Actual)	2018–19 (Actual)	2019–20 (BE)	2019–20 (RE)	2020–21 (BE)	2018–19 (Actuals) over 2017–18 (Actuals)	2019–20 (RE) over 2019–20 (BE)	2019–20 (RE) over 2018–19 (Actuals)	2020–21 (BE) over 2019–20 (RE)
1	Revenue receipts	14,35,233 (8.4)	15,52,916 (8.2)	19,62,761 (9.6)	18,50,101 (9.1)	20,20,926 (9.0)	8.2	(-)5.7	19.1	9.2
2	Tax revenue (net to centre)	12,42,488 (7.3)	13,17,211 (6.9)	16,49,582 (8.1)	15,04,587 (7.4)	16,35,909 (7.3)	6.0	(-)8.8	14.2	8.7
3	Non-tax revenue	1,92,745 (1.1)	2,35,705 (1.2)	3,13,179 (1.5)	3,45,514 (1.7)	3,85,017 (1.7)	22.3	10.3	46.6	11.4
4	Non-debt capital receipts	1,15,678 (0.7)	1,12,779 (0.6)	1,19,828 (0.6)	81,605 (0.4)	2,24,967 (1.0)	(-)2.5	(-)31.9	(-)27.6	175.7
5	Total receipts (1+4)	15,50,911 (9.1)	16,65,695 (8.8)	20,82,589 (10.2)	19,31,706 (9.4)	22,45,893 (10.0)	7.4	(-)7.2	16.0	16.3
6	Total expenditure through budget	21,41,973 (12.5)	23,15,113 (12.2)	27,86,349 (13.6)	26,98,552 (13.2)	30,42,230 (13.5)	8.1	(-)3.2	16.6	12.7
7	Total expenditure (excluding loans and advances; debt repayments)	24,65,201 (14.4)	26,61,094 (14.0)	31,14,973 (15.2)	30,52,196 (14.9)	33,32,061 (14.8)	7.9	(-)2.0	14.7	9.2
8	Revenue expenditure	18,78,833 (11.0)	20,07,399 (10.6)	24,47,780 (7.4)	23,49,645 (11.5)	26,30,145 (11.7)	6.8	(-)4.0	17.0	11.9
9	Revenue deficit	4,43,600 (2.6)	4,54,483 (2.4)	4,85,019 (2.3)	4,99,544 (2.4)	6,09,219 (2.7)	2.5	3.0	9.9	22.0
10	Fiscal deficit (6-5)	5,91,062 (3.5)	6,49,418 (3.4)	7,03,760 (3.3)	7,66,846 (3.8)	7,96,337 (3.5)	9.9	9.0	18.1	3.8
11	Off budget borrowings (12-10)	3,23,228 (1.9)	3,45,981 (1.8)	3,28,624 (1.6)	3,53,644 (1.7)	2,89,831 (1.3)	7.0	7.6	2.2	(-)18.0
12	True fiscal deficit (7-5)	9,14,290 (5.3)	9,95,399 (5.2)	10,32,384 (5.1)	11,20,490 (5.5)	10,86,168 (4.8)	8.9	8.5	12.6	(-)3.1
13	Primary deficits	62,110 (0.4)	66,770 (0.4)	43,289 (0.2)	1,41,741 (0.7)	88,134 (0.4)	7.5	227.4	112.3	(-)37.8

Figures in parentheses indicate percentage of GDP. BE: Budget estimates. RE: Revised estimates.

Source: Actuals and budget estimates have been taken from *Budget at a Glance* for 2019–20 and 2020–21; Total expenditure has been taken from *Annual Financial Statement 2020–21*.

It is projected to grow by 12.8% in 2020–21. There is also the growing share of cess and surcharges, which are not shared with the states.

In contrast, total central tax revenue, net of states share, is projected to grow at a conservative rate of 8.7%, though it grew by over 14% in 2019–20. This is presumably attributable to the large shortfall in the GST compensation cess, compared to the mandated volume of compensation to be transferred to the states. In sum, though some projections are unduly optimistic, the overall projection of tax revenue (net to centre) is more realistic than the fairy-tale tax revenue projections of the last two years.

Non-tax revenue growth is projected to decelerate sharply to 11.4% in 2020–21 (BE), down from 46.6% in 2019–20 (RE) (Table 2). This is mainly on account of the projected decline in dividends and profits by over 22% after having grown by a massive 76.2% in 2019–20 (RE). The flip-flop derives mainly from the huge transfer of RBI surpluses last year, based on the recommendations of the Jalan Committee.

Non-debt capital receipts, which declined by 2.5% in 2018–19 and a further 27.6% in 2019–20 (RE), are now projected to increase by nearly 176% in 2020–21 (BE). This reflects the planned disinvestment of government equity amounting to ₹210 lakh crore in public enterprises like the Life Insurance Corporation of India, the Industrial Development Bank of India, etc. Such large divestment will be a challenge of considering that the government managed to divest only ₹65,000 crore in 2019–20 against a target of ₹105 lakh crore (Table 2). More important is the question of whether the proceeds will be spent on capital formation or on revenue expenditure. That would be akin to a distressed household selling off family assets to meet consumption expenses.

Expenditure Allocation

From the perspective of demand generation and equity, the allocation of expenditure is mixed. Among the broad categories of expenditure, expenditure on social services has grown the fastest at 11.8%, while expenditure on economic services has grown at 5.7% (Table 3, p 22). However, this is mainly a small base effect. Total social services expenditure accounts for less than 5% of the total expenditure, compared to about 34% for economic services. The maximum share goes to general services, at 43.6%, with interest payments—the largest component—eating up as much as 22%. This is a large leakage from the demand-generating expenditure stream. The second largest component, defence, is projected to

Table 2: Revenue and Receipts

		₹ Crore					% Change			
		2017–18 (Actual)	2018–19 (Actual)	2019–20 (BE)	2019–20 (RE)	2020–21 (BE)	2018–19 (Actuals) over 2017–18 (Actuals)	2019–20 (RE) over 2019–20 (BE)	2019–20 (RE) over 2018–19 (Actuals)	2020–21 (BE) over 2019–20 (RE)
1	Revenue receipts (3 + 10)	14,35,233 (8.4)	15,52,916 (8.2)	19,62,761 (9.6)	18,50,100 (9.1)	20,20,926 (9.0)	8.2	(-)5.7	19.1	9.2
2	Tax revenue (gross)	19,19,009 (11.2)	20,80,465 (11.0)	24,61,195 (12)	21,63,423 (10.6)	24,23,020 (10.8)	8.4	(-)12.1	4.0	12.0
3	Tax revenue (net to centre)	12,42,488 (7.3)	13,17,211 (6.9)	16,49,582 (8.1)	15,04,587 (7.4)	16,35,909 (7.3)	6.0	(-)8.8	14.2	8.7
4	Direct tax[1]	10,02,037 (5.9)	11,36,616 (6.0)	13,35,000 (6.5)	11,70,000 (5.7)	13,19,000 (5.9)	13.4	(-)12.4	2.9	12.7
5	Indirect tax[2]	9,16,972 (5.4)	9,43,852 (5.0)	11,26,195 (5.5)	9,93,423 (4.9)	11,04,020 (4.9)	2.9	(-)11.8	5.3	11.1
6	Central GST	2,03,262 (1.2)	4,57,535 (2.4)	5,26,000 (2.6)	5,14,000 (2.5)	5,80,000 (2.6)	125.1	(-)2.3	12.3	12.8
7	UT GST	1,635 (0.0)	2,778.2 (0.0)	2,768 (0.01)	2,704 (0.01)	3,000 (0.01)	69.9	(-)2.3	(-)2.7	10.9
8	Integrated GST	1,76,688 (1.0)	28,945 (0.2)	28,000 (0.1)			(-)83.6			
9	GST compensation cess	62,612 (0.4)	95,081 (0.5)	1,09,343 (0.5)	98,327 (0.5)	1,10,500 (0.5)	51.9	(-)10.1	3.4	12.4
10	Non-tax revenue	1,92,745 (1.1)	2,35,705 (1.2)	3,13,179 (1.5)	3,45,513 (1.7)	3,85,017 (1.7)	22.3	10.3	46.6	11.4
11	Interest receipts	13,574 (0.1)	12,145 (0.1)	13,771 (0.1)	11,027 (0.1)	11,042 (0.1)	(-)10.5	(-)19.9	(-)9.2	0.1
12	Dividends and profits[3]	91,361 (0.5)	1,13,420 (0.6)	1,63,528 (0.8)	1,99,893 (1.0)	1,55,395 (0.7)	24.1	22.2	76.2	(-)22.3
13	Non-debt capital receipts	1,15,678 (0.7)	1,12,779 (0.6)	1,19,828 (0.6)	81,604 (0.4)	2,24,967 (1.0)	(-)2.5	(-)31.9	(-)27.6	175.7
14	Disinvestment of government equity[4]	1,00,045 (0.6)	94,727 (0.5)	1,05,000 (0.5)	65,000 (0.3)	2,10,000 (0.9)	(-)5.3	(-)38.1	(-)31.4	223.1

Figures in parentheses indicate percentage of GDP. BE: Budget estimates. RE: Revised estimates.

1 Direct tax includes income, corporate and other minor direct taxes. These are gross figures inclusive of states' share.

2 Indirect tax includes central GST, UT GST, integrated GST, GST compensation cess, customs, union excise duties and other minor indirect taxes of the central government.

3 Dividends and profits accounted for 1.0% and 0.7% of GDP in 2019–20 (RE) and 2020–21 (BE) respectively. Among its sub components, surplus of Reserve Bank of India, nationalised banks and financial institutions amount to ₹1,51,637 crore in 2019–20 RE and ₹89,649 crore in 2020–21 BE.

4 Disinvestment of government equity increased from 0.3% of GDP to 0.9% between 2019–20 (RE) and 2020–21 (BE). The government plans to get ₹90,000 crore from disinvestment of government stake in LIC and IDBI Bank.

Source: Same as Table 1.