Fiscal Compression, Jeopardised Recovery, the Humanitarian Crisis and Reforms

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This paper assesses the impact of the budget on the economic recovery, debt dynamics and fiscal–monetary policy interaction. It also looks at how the budget has addressed issues of lives and livelihoods. It concludes by noting that the fiscal stance of compression in the 2021–22 budget has jeopardised an already faltering economic recovery that is now jeopardised by the second wave of the pandemic.

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Formulated against the backdrop of an unprecedented economic contraction and the continuing pandemic, now in its second wave, the fiscal stance of the 2021–22 budget is surprisingly contractionary and insensitive to the humanitarian crisis. But the menu of reforms it has announced, barring retrograde changes in tariffs, could have a strong positive impact on long-term growth if effectively implemented along with a fiscal stimulus. This paper discusses the short-term impact of the budget on stalling recovery along with related debt dynamics and monetary policy issues. The weak response of the budget to the humanitarian crisis and possible long-term growth implications of the reform programme it has announced are also investigated.

We start with a few preliminary remarks. First, the greater transparency in the budget needs to be appreciated, particularly with regard to the deficit. Since finance ministers are sensitive to the bad optics of large fiscal deficits, there has often been a tendency for the budget team to find ways of understating the size of the fiscal deficit, especially the recourse to off-budget borrowing. Analysts would have to compute the total public sector borrowing requirement (PSBR) to get a better sense of the fiscal stance in a budget. This problem had become acute in recent years, especially after the large food subsidy bill was shifted to the account of the Food Corporation of India (FCI), which financed the subsidy with loans from the National Small Savings Fund (NSSF). In her budgets, the finance minister has attempted to make the true size of the deficit more transparent by including statements specifying the extent of off-budget borrowing, and in this budget, she has brought the food subsidy back into the budget, including the outstanding liabilities of FCI to the NSSF on this account.

Another concern that has been addressed is the sharp deterioration in the central government's fiscal marksmanship in recent years, particularly with regard to revenues and the fiscal deficit. In 2015–16, the actual non-debt receipts were higher than in the budget estimate (BE) and actual fiscal deficit was about 4% less than the budget estimate (BE) (Figure 1a). In 2016–17, the actual non-debt receipts and the fiscal deficit were about the same as in the BE. But by 2019–20, actual non-debt receipts fell short of the BE by 16% while actual expenditure was relatively close to the BE, falling short by about 4%. As a result, the actual fiscal deficit fell short of the BE by a massive 33%. As a consequence of such large deviations between the BE and actual, the BE became an ineffective tool for assessing the true fiscal stance of the government either by analysts or the government itself.

Figure 1a: Deviation of Actuals from Budget Estimate (%)—Centre

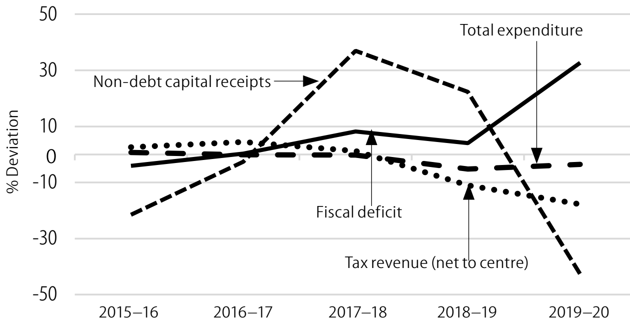
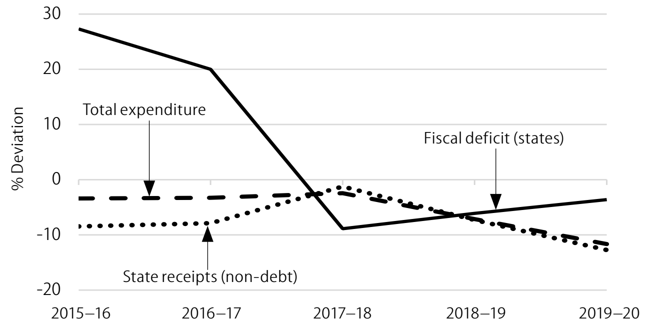
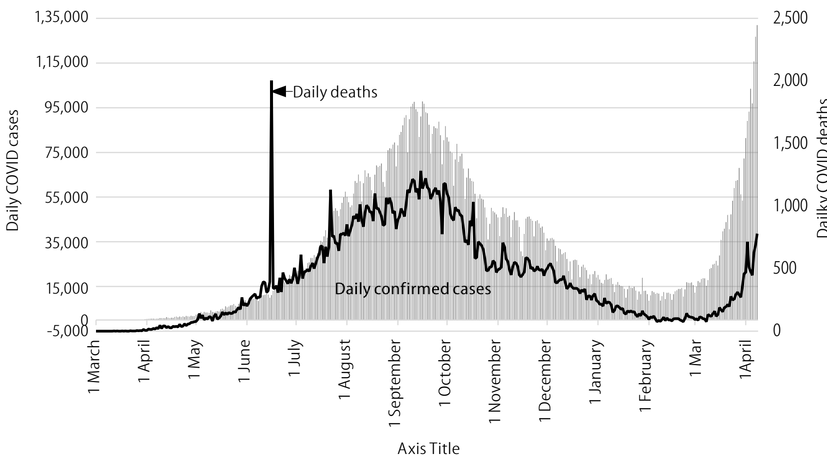


Figure 1b: Deviation of Actuals from Budget Estimate (%)—States



Source: Budget at a Glance (various issues) and RBI State Finances (various issues).

Figure 2: Daily COVID-19 Trend since 1 March 2020—New Confirmed Cases and Deaths



Source: Ministry of Health and Family Affairs.

In the case of the states, the picture was different. Because of the hard constraint of their respective Fiscal Responsibility and Budget Management (FRBM) Acts, from 2017–18 onwards their actual fiscal deficits could not deviate much from the BEs. Though there were large shortfalls in revenue, these had to be passed as cuts in expenditure (Figure 1b).

For the central budget, the story has now changed. The sharp economic contraction completely undermined the 2020–21 BE projections. But the revised estimates (2020–21 RE) as given in the 2021–22 budget are realistic, perhaps even too restrained. Tax revenue estimates in the RE have already been exceeded by the actual flow of tax revenues, which were quite buoyant during the last two quarters of 2020–21. Hence, the actual fiscal deficit for 2020–21 may turn out to be somewhat lower than that anticipated in RE.

Finally, in assessing the impact of the 2020–21 budget, two contextual features need to be kept in mind, one domestic and one external. Domestically, there is now a second wave of the COVID-19 pandemic which has been spreading exponentially (Figure 2). The rise of cases and deaths is so far concentrated in about 50 districts mostly in Maharashtra, Chhattisgarh, Karnataka, Uttar Pradesh, Delhi, Madhya Pradesh, Tamil Nadu, Gujarat and Kerala, but it is a dynamic situation changing by the day. Health workers and administrators are much more experienced now in formulating containment strategies as well as in treatment of patients who have tested positive. Vaccines are also now available and the vaccination programme, the largest in the world, is rapidly gathering momentum. There is reason to hope, therefore, that the second wave will not be as costly as the first one in terms of loss of lives and livelihoods. However, there is still a great deal of uncertainty about how the pandemic will continue to unfold and the extent of its further adverse impact on economic performance.

Externally, though there have been second and third waves of the pandemic in other countries, especially in Europe and the United States (US), mass application of vaccines has contained the severity of infections and deaths. Also, in the US, the massive stimulus package introduced by the new administration is generating a rapid revival of economic activity. US growth is now expected to grow in the range of 4% to 6% by different forecasters. Such high growth in the largest economy in the world, coupled with positive growth in China, the second largest economy, will most likely lead to a resurgence of global growth. This will also have a significant impact on India's economic performance.

Fiscal Compression Risks Recovery

The pandemic struck India at a time when growth had already been declining since Q3 of 2017–18. The nationwide lockdown that followed in late March 2020, one of the most stringent in the world, dealt a severe negative shock to the economy on top of the pre-existing deceleration, leading to a year-on-year (y-o-y) gross domestic product (GDP) decline of nearly 24% in Q1 of 2020–21. However, there was an equally sharp recovery since June 2020 that led us to forecast that the contraction would be eliminated by Q3 and GDP would register positive y-o-y growth of 2% in Q4. Of course, this would still imply a contraction of 7.3% for the full year of 2020–21 (NCAER 2020). The forecast by the Reserve Bank of India (RBI), government and most others was in the same ballpark. It is important to emphasise that the sharp v-shaped recovery was attributable as much to government expenditure-driven revival of aggregate demand as to gradual unlocking of the economy on the supply side. The central government was widely criticised for not doing much to revive

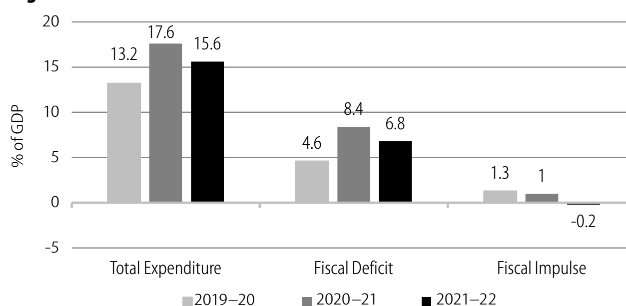
growth. But the fact is that despite the collapse of revenues, the central government ramped up its spending by a massive 28% y-o-y to ₹34.5 trillion (Table 1). Much of it was financed by a huge 100% increase in borrowing, about ₹16 trillion against the budgeted borrowing programme of about ₹8 trillion.[1]

Unfortunately, the central government did not provide support early enough to the state governments, who account for nearly two-thirds of total government spending and were in the forefront of having to deal with the pandemic as well as the humanitarian crisis that came with it. The states also suffered a collapse in their revenues and were faced by a hard deficit limit because of their respective FRBM acts. Hence, they were forced to cut their spending at this critical juncture. However, the central government provided additional support and extra borrowing headroom for the states later in the year. So, for the whole year of 2020–21, the combined fiscal deficit of all government is estimated to have ballooned to about 14.2% of GDP (Appendix Table A2), and over 15% in terms of the PSBR if we were to include the off-budget borrowing.[2] Without this massive deficit, the v-shaped recovery would have been much more muted.

Despite the significant stimulus, there are some concerning signals that the recovery may be faltering. Official GDP estimates indicate that the pace of recovery had already slowed during Q3 and Q4 of 2020–21. Gross value added (GVA) in services, which accounts for 51% of the economy, was still declining y-o-y in Q3 and Q4. On the demand side, government final consumption expenditure (GFCE) and private final consumption expenditure was also still declining y-o-y during the same period, though capital expenditure finally started growing (Government of India 2021a). This slowdown of the recovery is confirmed by several high-frequency indicators at a more granular level (NCAER 2020).

The important takeaway from the discussions above is that to secure the recovery till the economy normalises, it is essential to maintain a high level of government spending to pump-prime demand, even if this entails another year of heavy borrowing. As against this requirement, the central government

Figure 3: Indicators of Fiscal Stance



(i) Total expenditure is 2019–20 actuals, 2020–21 RE and 2021–22 BE.
(ii) Fiscal deficit is 2019–20 actuals, 2020–21 post-RE and 2021–22 BE.
(iii) Fiscal impulse is the budget balance impact of discretionary fiscal policies.

has been surprisingly conservative, budgeting an expenditure growth of only 1% in nominal terms. This implies an actual decrease in real terms. As a proportion of GDP, expenditure is being reduced from 17.7% in 2020–21 to 15.6%, that is, a severe compression of over 2% of GDP in a single year. Further, the planned expenditure for 2021–22 includes ₹35,000 crore allocated for the vaccination programme and Fifteenth Finance Commission grants amounting to another ₹49,000 crore. Factoring that in, the discretionary compression of expenditure on other items would be even more severe as Govinda Rao (2021) has pointed out.

Another indicator for assessing the fiscal stance of the central government is the proposed change in the fiscal deficit. The budget proposes to reduce the fiscal deficit from 8.4% of GDP in 2020–21 to 6.8% of GDP in 2021–22,[3] that is a 160 percentage point compression in a single year, which is quite severe. A third way of assessing the fiscal stance is to calculate the fiscal impulse, namely "the change in the government budget balance resulting from changes in government expenditure or tax policies" (Shinasi and Lutz 1991).[4] In their recent paper, Chinoy and Jain (2021) have estimated that the fiscal impulse declined from 1.3% and 1% of GDP, respectively, in 2019–20 and 2020–21 to a negative (-)0.2% in the 2021–22 BE, again a sharp compression. Had they not adjusted for the spending on the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), a

Table 1: Receipts, Expenditure and Deficits

		₹ Crore					% Change			
		2018–19 (actuals)	2019–20 (actuals)	2020–21 (BE)	2020–21 (post RE)	2021–22 (BE)	2019–20 (Actuals)/ 2018–19 (Actual)	2020–21 (RE)/ 2020–21 (BE)	2020–21 (RE)/ 2019–20 (Actuals)	2021–22 (BE)/ 2020–21 (RE)
	1	2	3	4	5	6	7	8	9	10
1	Revenue receipts	15,52,916 (8.2)	16,84,059 (8.3)	20,20,926 (9.0)	15,55,154 (7.9)	17,88,425 (8.0)	8.4	(-)23.0	(-)7.7	15.0
1.1	Tax revenue (net to centre)	13,17,211 (7.0)	13,56,902 (6.7)	16,35,909 (7.3)	13,44,501 (6.9)	15,45,396 (6.9)	3.0	(-)17.8	(-)0.9	14.9
1.2	Non-tax revenue	2,35,705 (1.2)	3,27,157 (1.6)	3,85,017 (1.7)	2,10,652 (1.1)	2,43,028 (1.1)	38.8	(-)45.3	(-)35.6	15.4
2	Non-debt capital receipts	1,12,779 (0.6)	68,620 (0.3)	2,24,967 (1.0)	46,497 (0.2)	1,88,000 (0.8)	(-)39.2	(-)79.3	(-)32.2	304.3
3	Total receipts (1+2)	16,65,695 (8.8)	17,52,679 (8.6)	22,45,893 (10.0)	16,01,650 (8.2)	19,76,424 (8.9)	5.2	(-)28.7	(-)8.6	23.4
4	Total expenditure	23,15,113 (12.3)	26,86,330 (13.2)	30,42,230 (13.5)	34,50,305 (17.6)	34,83,236 (15.6)	16.0	13.4	28.4	1.0
4.1	Revenue expenditure	20,07,399 (10.6)	23,50,604 (11.6)	26,30,145 (11.7)	30,11,142 (15.4)	29,29,000 (13.1)	17.1	14.5	28.1	(-)2.7
5	Revenue deficit (4.1-1)	4,54,483 (2.4)	6,66,545 (3.3)	6,09,219 (2.7)	14,55,989 (7.4)	11,40,576 (5.1)	46.7	139.0	118.4	(-)21.7
6	Fiscal deficit (4-3)	6,49,418 (3.4)	9,33,651 (4.6)	7,96,337 (3.5)	16,48,655 (8.4)	15,06,812 (6.8)	43.8	132.1	98.0	(-)8.6
7	Primary deficits	66,770 (0.4)	3,21,581 (1.6)	88,134 (0.4)	11,55,755 (5.9)	6,97,111 (3.1)	381.6	1211.4	259.4	(-)39.7
8	Extra budgetary resources (EBRs)	1,62,602 (0.9)	1,48,316 (0.7)	1,86,100 (0.8)	1,26,095 (0.6)	30,000 (0.1)	(-)8.8	(-)32.2	(-)15.0	(-)76.2

(1) Figures in parenthesis indicate percentage of GDP, (2) BE: Budget Estimates. RE: Revised Estimates, AE: Advanced Estimates, (3) GDP (₹ crore) 2018–19: 1,88,86,957 (2nd Revised Estimates), 2019–20: 2,03,51,013 (1st Revised Estimates), 2020–21: 2,24,89,420 (BE), 2020–21: 1,95,86,161 (2nd Revised Estimates), 2021–22: 2,22,87,379 (BE), (4) EBRs in row 11 includes government fully serviced bonds, NSSF loan and other resources. Taken from Appendix Table 1.
Source: Actuals and budgeted estimates are from Budget at a Glance for 2020–21 and 2021–22.

discretionary expenditure allocation in our view, the compression would have been even sharper at (-)0.5%.[5]

In other words, whichever way we choose to assess the fiscal stance of the 2021–22 budget, it turns out that it entails a sharp compression (Figure 3). This is unfortunate at a time when the policy priority surely is to revive the economy after the unprecedented 8% contraction in 2020–21. Indeed, it is quite surprising that the budget adopted such a stance when it was fairly obvious that it needed to adopt an expansionary stance. What could account for this?

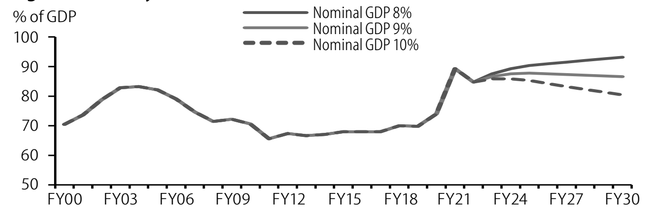
There are three possible explanations. One, the budget team has allowed for a significant shortfall in the ambitious disinvestment target of ₹1.75 trillion, in which case the actual deficit would be larger than in the 2021–22 BE. Second, a concern about the huge increase in the fiscal deficit. This is quite understandable since the combined fiscal deficit of the central and state governments ballooned to over 14% of the GDP in 2020–21, over 15% if we factor in the off-budget borrowing. This has pushed up the public debt to GDP ratio to around 90%. Debt dynamics and monetary policy implications of the steep increase in public debt are discussed further below. A robust fiscal consolidation programme certainly has to be launched as soon as economic conditions permit. Third, the budget team has possibly assumed that GDP growth in 2021–22 will be high despite fiscal compression because of the strong base effect of the sharp economic contraction in 2020–21, and therefore decided to immediately initiate the fiscal consolidation process. However, such an approach could be self-defeating because the fiscal compression itself can jeopardise the recovery. Already, there are some signs of the recovery losing momentum through Q3 and Q4 of 2020–21 as was discussed above. It would have been more prudent to postpone the consolidation for at least a year or two, allowing time for securing the recovery from the severe negative shock of 2020–21.

Debt Dynamics

The sharp increase in public debt has once again raised concerns about the risks of a debt trap. How much debt is sustainable? Way back in the 1940s, Domar (1944) had demonstrated that an economy could sustain a rising debt to GDP ratio so long as the rate of growth (g) exceeds the rate of interest (r). A somewhat refined version of the ($g > r$) rule has recently been revived by Blanchard (2019). However, as several authors have cautioned, it is important not to be complacent about public borrowing in the presence of high fiscal dominance and a large primary deficit as in India (Chinoy and Jain 2021; Rao 2021; Subramanian and Felman 2021). In this context, it is interesting that while the central government has prematurely imposed strong fiscal compression in the 2021–22 budget, which can jeopardise the recovery to normal growth, it has at the same time adopted a very gradual approach to fiscal consolidation over the medium term.

Recognising that the unprecedented economic contraction following the pandemic had rendered the pre-existing FRBM targets irrelevant, the Fifteenth Finance Commission (Fifteenth FC) recommended a gradual fiscal consolidation path. It

Figure 4: Debt Dynamics under Different Growth Scenarios



Source: Chinoy and Jain (2021), (we gratefully acknowledge the authors' permission to reproduce the figure).

recommended bringing down the central fiscal deficit by about 0.5% of GDP each year to 4% of GDP by 2025–26, while the states' fiscal deficit is to be reduced and stabilised at the original FRBM target of 2.8% of the GDP by 2023–24, leaving a combined fiscal deficit of 6.8% even at the end of 2025–26 (Finance Commission 2020). The Fifteenth FC proposal regarding the deficit reduction path of the states was accepted by the central government in its action taken report on the Fifteenth FC recommendations. However, for the central government's own fiscal deficit, the finance minister has given it an additional borrowing headroom of 0.5% of GDP in 2025–26, that is, a central fiscal deficit of 4.5% of GDP even five years down the line. In other words, after the sharp compression of the fiscal deficit by over 2% of GDP in a single year in 2021–22, at a time when the economy is struggling to get back to the pre-COVID-19 2019–20 GDP level, the budget then provides curiously for a very gradual compression of less than 0.5% per year for the next five years.

The combined fiscal deficit is thus expected to come down from around 14.2% of GDP at the end of 2020–21 to about 7.3% of GDP at the end of 2025–26. How this will impact the debt to GDP ratio, which is currently estimated at close to 90%, will depend primarily on the medium-term growth path of the economy. Chinoy and Jain (2021) have demonstrated in an interesting exercise that there is a knife edge around the nominal growth rate of 9%. At a nominal growth rate below this level, the debt to GDP ratio will be rising, while at a nominal growth rate of 9% or more, the debt to GDP ratio will be declining. Assuming the RBI is able to contain average headline inflation at 5%, the required real growth rate to ensure a declining debt to GDP ratio will be only 4%, which seems eminently achievable.

Thus, the medium-term debt dynamics need not cause much concern. It is important to note that despite the strong fiscal compression in 2021–22, the combined fiscal deficit of the centre (6.8% of GDP) plus states (3.3% of GDP) would still be very large at over 10% of GDP. To absorb this large-scale public borrowing without allowing yields to rise and crowd out private borrowers, the RBI will have to continue to adopt an accommodating monetary policy stance. A combination of conventional and unconventional liquidity management measures similar to those it implemented very successfully in 2020–21, such as open market operations (OMO), targeted long-term repo operation (TLTRO), Twist, etc, would have to be pursued again this year. It has already started that process with its 7 April announcement of governments security aquisition programme (G-SAP 1), the ₹1 trillion purchase of 10 year G-SECs through special OMO, which immediately reduced yields.

However, pursuit of this Indian version of quantitative easing could become more challenging if the expected surge in US economic growth and possible increase in US interest rates leads to a net outflow of portfolio investments from emerging market economies like India.

Weak Budget Response

The discussion above assessed the budget through the macroeconomic lens of its impact on economic recovery, debt dynamics and fiscal-monetary policy interaction. We now look at the budget through a different lens, namely how it has addressed the severe distress arising from the loss of both lives and livelihoods as a consequence of the pandemic and the lockdown that followed.

We start by looking at how the lockdown impacted an unemployment situation that was already grim. As was noted at the outset, growth had been declining since Q3 of 2017–18 and by Q4 of 2019–20 it had declined to as little as 3%. This growth deceleration took its toll on employment and underemployment. Open unemployment is most visible in urban areas, for which we now have the high frequency Periodic Labour Force Survey (PLFS) data from the Ministry of Statistics and Project Implementation (MoSPI). In rural areas, unemployment is mostly disguised and takes the form of low wage-low productivity underemployment. It is reflected in data on wage trends rather than open unemployment.

Rural areas act as shock absorbers during periods of severe crisis when workers and the self-employed, who can no longer survive in the cities without livelihoods, flock to their village homes and family networks. They eke out some sort of existence by sharing out the available work at very low wages or by queuing up for work on MGNREG projects. Memories of such desperate migration to the villages in the middle of the pandemic are seared in our minds by the daily television images a year ago of thousands upon thousands of workers and their families trudging hundreds of miles home to somehow survive.

The PLFS data from the April–June 2020 round clearly show how urban unemployment spiked last year (Table 2). For the age group above 15 years, unemployment went up from 8.8% a year earlier, which was high enough, to as much as 20.8%, that is, one in every five persons of working age group became unemployed. For young workers in the 15–29 age group, the unemployment rate went up to 34.7%, implying one-third of workers in this age group became unemployed. These unemployment estimates, which refer to only those who are actually seeking work, understates the level of distress since a large proportion of potential workers simply withdraw from the workforce, that is, stop looking for work, out of hopelessness about the prospects of finding work. By April–June 2020, the labour force participation rate (LFPR) had come down to only 37.4% for the 15–29 age group. In other words, only about a third of young working-age persons were actively seeking work, and even among that, a third were unemployed or about three of every four young persons in the 15–29 age group either had no work or were not looking for work. The LFPR among young women in the 15–29 age group is even more alarming at only 17.8%.

Table 2: Unemployment Rate (%) in Current Weekly Status in Urban Areas

Survey Period	Male	Female	Persons
Age: 15–29 years			
April–June 2019	20.1	27.4	21.6
July–September 2019	19.6	24.1	20.6
October–December 2019	17.8	23.7	19.2
January–March 2020	20.2	24.2	21.1
April–June 2020	34.3	36	34.7
Age: 15 years and above			
April–June 2019	8.2	11.3	8.8
July–September 2019	8	9.7	8.3
October–December 2019	7.3	9.8	7.8
January–March 2020	8.6	10.6	9.1
April–June 2020	20.7	21.1	20.8
Age: all ages			
April–June 2019	8.3	11.3	8.9
July–September 2019	8	9.7	8.4
October–December 2019	7.3	9.8	7.9
January–March 2020	8.7	10.5	9.1
April–June 2020	20.8	21.2	20.9

Source: PLFS Quarterly Report, April–June 2020, MoSPI.

The official unemployment estimates are closely tracked by the estimates from the Centre for Monitoring Indian Economy (CMIE 2021), which reported that the unemployment rate for workers above 15 years in April–June 2020 (monthly average) was 19.9% as compared to the PLFS estimate of 20.8%. The strength of the CMIE data set is that it is very high frequency, giving us up-to-date monthly and weekly estimates. It also gives us the unemployment estimates for both rural and urban areas. The CMIE estimates for March 2021 show that unemployment rates had come down to 7.2% and 6.2%, respectively, in urban and rural areas (combined rate 6.5%), which are more or less comparable to the unemployment rates observed before the pandemic struck.

However, it would be erroneous to conclude from this that the economy is now back on a normal track because what the open unemployment estimates mask are the withdrawal from the labour force, reduced LFPR, and the extent of underemployment and deterioration in the quality of jobs with greater informalisation of the labour market in the wake of the economic contraction. Drawing on the PLFS panel data, Himanshu (2021a), has reported in a recent article that among casual wage workers, the worst affected in urban areas, only a third of those employed during January–March 2020 could retain their jobs in the subsequent period, but with reduced earnings, 5% became self-employed, 10% exited the labour force and 50% became unemployed. For rural areas, he cites Labour Bureau data in another article to show that rural non-agricultural and agricultural real wages both declined steeply during Q2 and Q3 (Himanshu 2021b).

Official data on MGNREGA employment reveals that 11.2 crore persons from 7.5 crore households sought MGNREGA employment in 2020–21, a 42% increase from 7.9 crore persons from 5.5 crore households in 2019–20, a distinct marker of heightened rural distress (Sharma 2021). Unfortunately, the average number of days of employment provided per household

was only 51 as compared to the permissible ceiling of 100 days. There is no evidence yet to suggest that the distress arising from such loss of livelihoods and incomes has been significantly alleviated. On the contrary, surveys that show a decline in food intake among a large section of respondents (APU 2020) coming on top of other symptoms of heightened nutrition distress noted even prior to the pandemic.[6] Basole (2021) provides a summary of the evidence on the loss of livelihood and the consequent distress among the affected population.

How has the 2021–22 budget responded to this humanitarian crisis? This question is best answered by analysing the allocations for key safety net schemes like the food subsidy, income support and the MGNREGA relief employment programme. The expenditure budget indicates that the allocation for food subsidy has been reduced from ₹4.2 trillion in 2020–21 (RE) to ₹2.42 trillion in 2021–22 (Table 3). However, a large part of the ₹4.2 trillion in 2021–22 is due to bringing back in the budget the food subsidies being provided off-budget through the FCI, along with FCI's liabilities to the NSSF. After adjusting for this, the food subsidy budget has remained about the same in 2021–22 as in 2020–21. The main vehicle for providing income support to farmers is the flagship Pradhan Mantri Kisan Samman Nidhi Yojana (PM-KISAN) programme. The allocation for PM-KISAN has been reduced to ₹65,000 crore in 2021–22 BE from the provision of ₹75,000 crore in 2020–21 BE.

The most important safety net for the rural poor, along with food subsidy, is the MGNREGA employment programme. As unemployment spiked, destitution spread and workers migrated back to their villages, there was a very sharp increase in the demand for MGNREGA work. As a parliamentary standing committee noted, there is no better scheme to provide sustainable livelihood to unskilled workers, including migrant labour (Bosale 2021). Further, the allocation for MGNREGA has been slashed from ₹1.1 trillion to ₹73,000 crore. Among other social expenditures, the allocation for medical and public health has been raised very significantly to nearly ₹70,000 crore, but much of the increase is accounted for by the ₹35,000 crore allocation for the COVID-19 vaccination programme and mandatory allocations because of grants provided for the health sector by the Fifteenth FC. The allocation for education is higher than the RE for 2020–21 but less than the BE provision.

A major thrust in this budget is to push capital expenditure, especially in infrastructure. The allocation for capital expenditure has been raised from ₹3.6 trillion in 2020–21 RE to over ₹5.3 trillion in 2021–22, an increase of nearly 50%. The allocation for infrastructure has gone up from about ₹4 trillion in 2020–21 (RE) to ₹5.6 trillion, a 40% increase. These are welcome developments, though under infrastructure, the allocation for the Pradhan Mantri Gram Sadak Yojana, by far the most employment-intensive infrastructure programme, has been reduced. However, the large increase in infrastructure and other capital expenditure need not have come at the cost of humanitarian relief. A senior finance ministry official is reported to have said that they faced a choice between "handouts" and infrastructure and they chose infrastructure. If true, it seems unspeakably insensitive to describe safety-net schemes in the worst crisis the economy has ever faced as "handouts," especially by a civil servant whose own livelihood, pay and perks are all secure. More important, it reflects a failure to understand that the real choice the finance minister faced was not between safety net spending and infrastructure but between larger total spending, on both infrastructure and safety net schemes, and less spending focused on infrastructure only. As was explained earlier, the former choice would have been far better even simply in terms of macroeconomic management because of the high multiplier effects of safety net spending for poor households deprived of their livelihoods.

Table 3: Central Government Expenditure Allocations

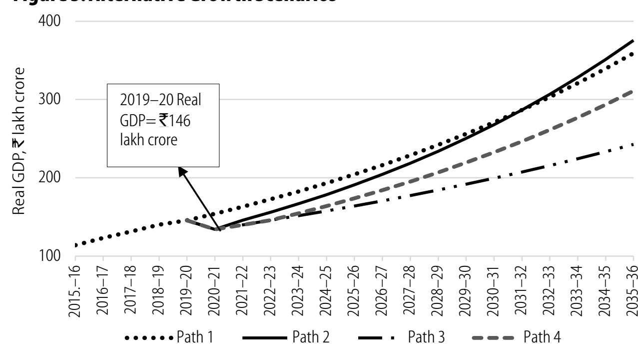
	Heads	Percent of Total Expenditure					% Change	
		2018–19 (Actuals)	2019–20 (actuals)	2020–21 (BE)	2020–21 (RE)	2021–22 (BE)	2021–22 (BE)/ 2020–21 (RE)	2021–22 (BE)/ 2019–20 (Actuals)
	1	2	3	4	5	6	7	8
1	Total expenditure (excluding loans and advances; debt repayments)	100	100	100	100	100	4.6	25.9
2	General services*	45.6	44.5	43.6	40.3	41.9	9.0	18.8
2.1	Interest payment and servicing of debt	22.4	21.8	22.0	20.3	22.4	15.6	29.3
2.2	Defence services	11.2	10.9	10.0	9.8	9.4	0.4	9.0
2.2.1	Defence services (capital account)	3.6	3.7	3.4	3.7	3.6	0.4	21.6
2.3.1	Food subsidy	3.8	3.6	3.5	11.7	6.4	(-)42.5	123.4
2.3.2	Fertiliser subsidy	2.7	2.7	2.1	3.7	2.1	(-)40.6	(-)2.0
2.3.3	Petroleum subsidy	0.9	1.3	1.2	1.1	0.4	(-)64.0	(-)63.5
3	Social services*	4.2	4.7	4.9	4.9	5.4	15.4	44.8
3.1	Education, sports, art and culture	1.6	1.7	1.7	1.3	1.4	10.5	5.6
3.2	Medical and public health	0.9	1.0	0.9	1.1	1.8	83.7	141.6
4	Economic services*	35.3	32.7	33.8	38.6	35.9	(-)2.8	38.0
4.1	Agriculture and allied activities	6.7	8.0	8.0	16.2	10.3	(-)33.8	62.5
4.1.1	PM KISAN	0.0	1.6	2.3	1.8	1.7	0.0	33.4
4.2	Rural development	2.4	2.5	1.9	3.2	2.0	(-)33.5	2.5
4.2.1	MGNREGA	2.3	2.4	1.8	3.1	1.9	(-)34.5	1.8
4.3	Infrastructure services	16.3	14.5	16.2	11.0	14.7	40.2	28.2
4.3.1	Irrigation and flood control	0.1	0.1	0.1	0.1	0.1	27.4	55.4
4.3.2	Energy	1.9	2.1	2.0	1.7	1.0	(-)36.4	(-)39.4
4.3.3	Transport	12.8	10.8	11.6	7.6	11.6	58.9	35.0
4.3.4	Communications	1.4	1.4	2.5	1.6	2.0	32.4	74.7
5	Grants-in-aid and contributions	14.4	17.7	17.1	15.7	16.3	8.4	15.8
6	Capital expenditure outside revenue account	15.0	12.9	11.7	9.9	14.1	48.8	37.9

* Subcategories under the item heads are not exhaustive.
(1) BE: Budget Estimates. RE: Revised Estimates, (2) Expenditure data are net expenditure of the centre.
Source: Expenditure Budget for 2020–21 and 2021–22.

High Long-term Growth

It has been argued above that the budget has jeopardised a fragile recovery because of its premature fiscal compression and that it has failed to address the humanitarian crisis triggered by the pandemic. However, it has done

Figure 5: Alternative Growth Scenarios



well when viewed through a third lens, namely the role of reforms in driving the economy back to high long-term growth.

With an 8% contraction in 2020–21, the second wave of the pandemic and strong fiscal compression, it seems unlikely that the economy will return to the 2019–20 GDP level before 2022–23. However, the important long-term question is what happens after that. In Figure 5, we have projected a counterfactual growth path (Path 1) if the pandemic had not happened and the economy continued to grow at the pre-existing trend growth path of 5.8%. We compare this benchmark with an optimistic Path 2 in which the economy recovers quickly, getting back to the 2019–20 GDP level by 2021–22, and then continues to grow above past trend at 7% per annum, a pessimistic Path 3 in which the economy reaches the 2019–20 output level only by the end of 2022–23 and then continues to grow at only 4% per annum, and a moderate Path 4 in which the economy catches up with the 2019–20 output level by 2022–23, but then continues to grow at 6% per annum. As shown in Figure 4, the pessimistic Path 3 stays permanently below the benchmark growth path and the moderate path catches up with the "no-pandemic" reference path in the mid 21st century. But even the optimistic Path 2 catches up with the counterfactual "no-pandemic" growth path only by 2031–32.

The pandemic shock did not set off India's unemployment problem, it only exacerbated it. For India to overcome its chronic high unemployment–underemployment problem, it is essential to grow by at least 7%–8%. But what will it take to get the economy to Path 2 or higher? The economy has been hit by an unprecedented negative shock the long-term effects of which, hysteresis, are indeed very long. The economy needs a strong positive shock to offset the effects of that negative shock and generate a positive hysteresis.

The many reforms announced in the budget are most promising from this perspective. One retrograde move is the reversal of tariff reforms for the fourth successive year, the protectionist tampering with tariff rates, mostly raising them, reverses the gains of tariff reforms going back 30 years and will adversely affect exports. But there are several other announced reforms which, if effectively implemented, could indeed push the economy to a high growth path of 7% or more.

The most important among these are the whole range of financial sector reforms. The creation of an asset reconstruction company and an asset management company to take over the stressed assets of public sector banks will clean up their balance sheets and enable them to resume normal lending and help revive economic activity. The privatisation of two public sector banks in addition to IDBI bank will raise resources for the government while professionalising the banks and reforming their governance. Of course, privatisation of banks by raising fresh majority equity instead of selling off government equity would have been a better way of simultaneously recapitalising these banks while reforming their management and governance (Mundle 2021a). Allowing up to 74% foreign direct investment in insurance companies and the planned public offering of Life Insurance Corporation of India shares are both significant moves towards further privatisation of the financial sector.

Two other major reforms announced in the budget include the launching of a privatisation programme for all except a few strategically important public enterprises and the preparation of an asset monetisation programme for the vast, underutilised assets of the government. On the establishment of a development finance institution (DFI), another major proposal, it is important to tread cautiously. Banks such as IDBI and ICICI were originally DFIs and there are many DFIs that still exist. However, their record of stressed assets is no better than that of the public sector banks. Finally, no new reforms for the agricultural sector were announced in the budget as the government had already passed three laws for reforming the sector. We have argued elsewhere that it would have been perfectly feasible to reform agriculture without recourse to these new laws and the immense farmers' agitation they have provoked (Mundle 2021b).

A Concluding Remark

Pulling together the threads of the discussion above, our overarching assessment is that the fiscal stance of compression in the 2021–22 budget has jeopardised an economic recovery that has already been faltering and is now even more uncertain because of the second wave of the pandemic. Moreover, the response of the budget to the humanitarian crisis triggered by the economic contraction has unfortunately been very weak. However, the package of reforms announced in the budget, particularly the financial sector reforms, could help offset the negative pandemic shock and nudge India back to a high growth path of 7%–8% necessary to overcome India's chronic high unemployment problem. However, this would happen only if the reforms are effectively implemented and supported by a prudently designed, employment intensive, fiscal stimulus.

NOTES

1 While the 2021–22 budget documents (RE) indicated total borrowing of ₹18.5 trillion, the government subsequently cut back its planned borrowing by ₹2 trillion because of higher-than expected-tax revenue flows during Q4 of 2020–21.

2 Even this is an underestimate since it excludes the off-budget borrowing of state governments, which is not insignificant.

3 The RE mentions a deficit of 9.5% of GDP for 2020–21 but this is likely to be less because of robust tax collections during Q4 not fully factored into the RE. See footnote 2 above.

4 There is general agreement that the fiscal impulse is defined as the change in the government budget balance resulting from discretionary changes in tax or expenditure policy, that

is, it should exclude any changes in the budget balance due to automatic changes in revenue or expenditure resulting from changes in the level of economic activity, including automatic stabilisers. However, there is no agreement on how this is to be measured. Thus, the OECD and the US President's Council of Economic Advisers use one method of measuring the fiscal impulse while the IMF and the German Council of Economic Experts use a different method of measuring it (Blejer and Cheasty 1991; Shinasi and Lutz 1991).

5 In a recent conversation Sajjid Chinoy remarked that MGNREGA allocation is indeed a discretionary policy and so is the allocation for subsidised food distribution, for which they had also corrected. Without these adjustments the impulse in 2020–21 would have been even higher, hence the compression in 2021–22 even sharper.

6 Factsheets on key indicators for 22 states/union territories from phase 1 of the National Family Health Survey-5 show a deterioration in malnutrition indicators such as stunting or wasting in a majority of the states (IIPS 2020).

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Appendix Table A1: Statement of Extra Budgetary Resources (₹ crore)

Sr No	Name of the Ministry/Department and Name of the Scheme	2018–19 (Actuals)	2019–20 (Actuals)	2020–21 (BE)	2020–21 (RE)	2021–22 (BE)
Part A:	Extra budgetary resources mobilised through issue of government fully serviced bonds					
1	Department of higher education Revitalising infrastructure and systems in education (RISE)			3,000		
2	Department of Health and Family Welfare Pradhan Mantri Swasthya Suraksha Yojana			3,000		
3	Ministry of Housing and Urban Affairs Pradhan Mantri Awas Yojana (PMAY)—Urban	20,000		10,000		
4	Department of Water Resources, River Development and Ganga Rejuvenation (i) Polavaram Irrigation Project	1,400	1,850		2,234	
	(ii) Pradhan Mantri Krishi Sinchai Yojana (Accelerated Irrigation Benefits Programme and other projects)	5,493	1,963	5,000	4,225	
5	Department of Drinking Water and Sanitation (i) Swachh Bharat Mission (Rural)	8,698	3,600			
	(ii) JalJeevan Mission/National Rural Drinking Water Programme			12,000		
6	Ministry of New and Renewable Energy (i) Grid Interactive renewable power, off-grid/distributed and decentralised renewable power					
	(ii) Pradhan Mantri-Kisan Urja Sanrakshan Evam Utthaan Mahabhiyan (PM-KUSUM)			1,000		
7	Ministry of Ports, Shipping and Waterways Inland Waterways Authority of India (IWAI) Projects					
8	Ministry of Power (i) Deen Dayal Upadhyaya Gram Jyoti Yojana/SAUBHAGYA	13,827	3,782	5,500	5,000	
	(ii) Power System Development Fund Projects	5,505				
9	Department of Rural Development Pradhan Mantri Awas Yojana (PMAY) – Rural	10,679	10,811	10,000	20,000	
	Total	65,602	22,006	49,500	31,459	0
Part B:	Financial support extended through loans from NSSF					
1	Department of food and public distribution Food Corporation of India#	97,000	1,10,000	1,36,600	84,636	
2	Ministry of Housing and Urban Affairs Building Materials and Technology Promotion Council		15,000		10,000	
3	Department of Fertilisers Metals and Minerals Trading Corporation		1,310			
4	Support to other public agencies (to meet requirement for additional resources, if any, under some specific scheme/project)					30,000
	Total	97,000	1,26,310	1,36,600	94,636	30,000
	Grand total (A+B)	1,62,602	1,48,316	1,86,100	1,26,095	30,000

NSSF loan amount outstanding with FCI as on 31 March 2020 was ₹2,54,600 crore.
Source: Annexure VI of Budget Speech.

Appendix Table A2: Extent of Combined Borrowings by Centre and States

	₹ Lakh Crore				% of GDP		
	2019–20 (Actuals)	2020–21 (BE)	2020–21 (post-RE)	2021–22 (BE)	2019–20 (Actuals)	2020–21 (post-RE)	2021–22 (BE)
Fiscal deficit (centre)	8	8	16.5	15.1	3.8	8.4	6.8
Fiscal deficit (states)	7	6.3	6.3*	6.3*	3.2	3.2*	2.8*
Additional borrowing headroom for states	0	0	5	5*	–	2.5	2.2*
Combined deficit	15	14	27.8	26.4	7	14.1	11.8

* Data not yet available, assumed same as in 2020–21 BE (https://www.rbi.org.in/Scripts/AnnualPublications.aspx?head=State%20Finances%20:%20A%20Study%20of%20Budgets).