# Inclusive Fiscal Adjustment for Reviving Growth

## Assessing the 2019–20 Budget

Sudipto Mundle, Satadru Sikdar

Unrealistic revenue projections leading to strong expenditure compression is primarily responsible for India's growth deceleration. Growth will decelerate further without a programme of deep fiscal adjustment. How a fiscal space, amounting to over 6% of the gross domestic product, can be freed through such an adjustment programme is demonstrated. This space can be potentially used for an inclusive public expenditure-led strategy for reviving growth.

Sudipto Mundle (*sudipto.mundle@gmail.com*) is Distinguished Fellow at the National Council of Applied Economic Research, New Delhi. Satadru Sikdar (*satadru.sikdar@nipfp.org.in*) is a faculty at the National Institute of Public Finance and Policy, New Delhi.

The 2019–20 budget indicates a marginal overshooting of the 2018–19 fiscal deficit to 3.4% of the gross domestic product (GDP) compared to the target of 3.3%, which has been reset as the new target for 2019–20. The new target for revenue deficit is set at 2.3% of GDP, and primary deficit, that is, the deficit net of interest spending for servicing past debt, is set to decline from 0.4% of GDP in 2016–17 and 0.3% in 2018–19 to 0.2% in 2019–20 (Table 1, p 33). This gives the impression of a more or less smooth gliding path of fiscal consolidation towards the final fiscal deficit target of 3%, as recommended by the N K Singh (Fiscal Responsibility and Budget Management Review) Committee.

### Expenditure Compression

Underlying this apparently benign path, however, is a huge shortfall of tax revenue, shifting of expenditure off budget to parastatals and strong expenditure compression in 2018–19, which is likely to be followed by a similar compression in 2019–20. This will lead to a further slowdown in growth which has already seen a sharp deceleration in the first quarter (Q1) of 2019–20. The revenue shortfall and expenditure compression shock in 2018–19 would have been more evident if instead of the "revised estimates for 2018–19, the 2019 budget had used the more up-to-date "provisional actuals" released by the Comptroller and Auditor General of India, as was done in the *Economic Survey* 2018–19.

**Decelerating revenue expenditure:** As shown in Table 1 (the centre's share of) tax revenue for 2018–19 fell short of the budget estimate by well over 11%, reflecting the increasingly poor fiscal marksmanship of the central government. Even in terms of actual performance, tax revenue increased by only 6% in 2018–19—down to less than half the 12.5% increase achieved in 2017–18—resulting in total revenue growth of only 8.9%. Accordingly, expenditures had to be compressed to keep the deficit in check. In particular, the growth of revenue expenditure had to be compressed to 6.9% in 2018–19, down from 11.1% in 2017–18 and short of the 2018 budget estimate by as much as 6.2%, quite unusual in an election year.

Given that baseline, the budget estimates for 2019–20 are completely unrealistic. The centre's tax revenue is expected to grow by 25.3% as compared to only 8.9% in 2018–19. Based on this, total revenue is projected to grow by 25.6%, compared to 8.9% in 2018–19. In line with these unrealistic revenue projections, total expenditure is projected to grow by 20.5% and revenue expenditure by 21.9%.[1] This is after shifting significant volumes of spending off budget. For instance, food subsidy to the tune of ₹70,000 crore has been shifted to the Food Corporation of India, which is expected to finance this through loans from the National Small Savings Fund. Such "creative" fiscal arithmetic to disguise the true size of the deficit notwithstanding,[2] the economy will be delivered a severe expenditure compression shock in 2019–20 on top of the expenditure shock of 2018–19. Clearly there will be a large revenue shortfall again in 2019–20 and a corresponding large compression of expenditure growth to limit any overshooting of the fiscal deficit target.

**Decelerating demand, misguided interventions:** This adverse government expenditure shock has to be set against a very challenging macroeconomic background. Globally, the International Monetary Fund has again reduced its growth forecasts for all the major advanced economies—the United States (US), Europe and Japan—as well as China and the emerging markets group. With the risk of three major global crises looming large—namely the China–US trade war, a "no deal" Brexit and the confrontation between Iran and the US–Saudi Arabia–Israel axis—the global growth outlook will deteriorate further. This in turn will lead to a further slowdown in India's export growth. Internally, investment growth has declined very sharply from 14.4% in the fourth quarter (Q4) of 2017–18 to only 3.6% in Q4 of 2018–19. Private final consumption demand has also been declining since the second quarter (Q2) of 2017–18. If government expenditure growth is further compressed in 2019–20, the adverse trend in all the demand drivers will further depress growth that was already decelerating in 2018–19.

In response to the widespread concern about the growth deceleration, the government announced a slew of post-budget measures on 24 August 2019, followed by an announcement of the merger of several public sector banks. Further announcements may follow. Unfortunately, most of these announced measures address the complaints of specific interest groups, such as foreign portfolio investments (FPIs), automobile companies, real estate companies, public sector banks, non-banking financial companies (NBFCs), small and medium-sized enterprises (SMEs), etc. They may indeed give some relief to these particular interest groups. For example, the withdrawal of the surcharge on capital gains flight could well reverse the outflow of FPI since the budget, estimated at around ₹24,500 crore. This would in turn arrest the decline of the stock market and possibly also reverse the depreciation of the rupee.

However, these are piecemeal supply-side interventions when the real problem is the collapse of aggregate demand. What is missing is an effective macroeconomic strategy to revive demand-led growth. For instance, the revenue impact of the tax relief measures announced would be negative and further aggravate the potential expenditure shock unless the deficit target is relaxed. The reversal of rupee depreciation would adversely impact export growth. The infusion of ₹70,000 crore to recapitalise banks, already on the cards in the budget, is a positive move. But, this may not have much impact on growth without a thorough resolution of the non-performing loans problem and cleaning up of bank balance sheets. Other monetary measures, like the linking of bank lending rates to the repo rate is desirable in themselves for improving transmission and the supply of credit. But, these measures could be like pushing on a loose string when the binding constraint on credit flow may be lack of credit demand in some segments and credit exposure limits for other segments. Hence, it is unlikely that these post-budget measures will reverse the expected growth deceleration in 2019–20.

In its recent *Quarterly Review of the Economy*, the National Council of Applied Economic Research (NCAER 2019) has forecast that the annual growth will further decelerate to 6.2% ± 0.5% in 2019–20. Other institutions like the rating agency Moody's Investors Service is reported to be making growth forecasts of the same order.[3] The recently released quarterly estimates of GDP confirm that the growth deceleration is getting sharper. Growth, which had already declined to 5.8% in Q4 of 2018–19, has declined further to 5% during Q1 of FY 2019–120 (GoI 2019). If this pattern persists, the annual growth for financial year (FY) 2019–20 could clearly fall well below 6%.

## Revenue Shortfall and Capital Receipts

Before turning to a possible strategy to address this challenging macroeconomic scenario, we first delve deeper into the sources of revenue shortfall in 2018–19 and the outlook for 2019–20.

**Deficient tax revenues:** As noted earlier, revenues fell short of the budget estimate by 9.4% in 2018–19, entirely on account of the shortfall in tax revenues. Non-tax revenues actually exceeded the budget estimate, having grown by nearly 28% in 2018–19. In contrast (the centre's share of) tax revenues grew by only 6%, falling short of the 2018–19 budget estimate by over 11%. Among different taxes, there was a modest shortfall of 0.8% in direct taxes while indirect taxes fell short by as much as 16.2% (Table 2, p 34). The indirect tax shortfall was mainly on account of the shortfall in the goods and services tax (GST) collections. It is against this background that we find the tax revenue projections for 2019–20 completely unrealistic. The centre's total tax revenue is budgeted to grow by over 25% compared to only 6% last year and indirect tax revenue is budgeted to grow by nearly 20% compared to only 2.5% last year.[4]

**Dividend transfer:** On the non-tax revenue side, however, the projected growth of 27.2% in the budget estimate is quite realistic compared to 27.7% growth of the total non-tax revenue recorded last

**Table 1: Receipts, Expenditure and Deficits**

| | | 2016–17 (Actual) | 2017–18 (Actual) | 2018–19 (BE) | 2018–19@ (PA) | 2019–20 (BE) | % Change | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | ₹ in crore | | | (PA) 2018–19/ BE 2018–19 | PA 2018–19/ Actuals 2017–18 | BE 2019–20/ PA 2018–19 |
| (0) | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) |
| (1) | Revenue receipts | 13,74,203 | 14,35,233 | 17,25,738 (9.2) | 15,63,170 (8.3) | 19,62,761 | -9.4 | 8.9 | 25.6 |
| (2) | Tax revenue (net to centre) | 11,01,372 | 12,42,488 | 14,80,649 (7.9) | 13,16,951 (7.0) | 16,49,582 | -11.1 | 6.0 | 25.3 |
| (3) | Non-tax revenue | 2,72,831 | 1,92,745 | 2,45,089 (1.3) | 2,46,219 (1.3) | 3,13,179 | 0.5 | 27.7 | 27.2 |
| (4) | Non-debt capital receipts | 65,373 | 1,15,678 | 92,199 (0.5) | 1,02,885 (0.5) | 1,19,828 | 11.6 | -11.1 | 16.5 |
| (5) | Total receipts (1+4) | 14,39,576 | 15,50,911 | 18,17,937 (9.6) | 16,66,055 (8.8) | 20,82,589 | -8.4 | 7.4 | 25.0 |
| (6) | Revenue expenditure | 16,90,584 | 18,78,833 | 21,41,772 (11.4) | 20,08,463 (10.7) | 24,47,780 | -6.2 | 6.9 | 21.9 |
| (7) | Revenue deficit | 3,16,381 (2.1) | 4,43,600 (2.6) | 4,16,034 (2.2) | 4,45,293 (2.4) | 4,85,019 (2.3) | 7.0 | 0.4 | 8.9 |
| (8) | Fiscal deficit | 5,35,618 (3.5) | 5,91,062 (3.5) | 6,24,276 (3.3) | 6,45,367 (3.4) | 7,03,760 (3.3) | 3.4 | 9.2 | 9.0 |
| (9) | Primary deficit | 54,904 (0.4) | 62,110 (0.4) | 48,481 (0.3) | 62,692 (0.3) | 43,289 (0.2) | 29.3 | 0.9 | -30.9 |

Figures in parenthesis indicate percentage of GDP. BE: Budget estimates. PA: Provisional actuals.
Source: Actuals and budgeted estimates are collected from *Budget at a Glance* for 2018–19 and 2019–20; @ Provisional actuals are collected from monthly accounts (March 2018–19), Comptroller and Auditor General of India.

year. Embedded in this is a huge increase in the revenues from dividends and profits of public sector companies and financial institutions, especially the Reserve Bank of India (RBI). This is the main component of non-tax revenues and is projected to increase by 44.2% in the budget estimate for 2019–20, compared to 24.1% in 2018–19. As explained in Note 4, following the Jalan Committee report on the RBI reserves, the amount of dividend to be transfered to the central government that the RBI has announced is in an excess of ₹58,000 crore over and above the budget estimate. Assuming other components remain the same, this would entail over 50% growth in non-tax revenue, and a massive increase of 95.3% in "dividends and profits." Clearly public sector institutions, especially the RBI, are under considerable pressure to help finance the government's spending.

**Disinvestment:** Among non-debt capital receipts, by far the largest component (over 85%) is disinvestment of government equity. It is projected that in the current year the government will sell down its equity in public enterprises to the tune of ₹1,05,000 crore. It is an ambitious target, especially given the current depressed state of the stock market. However, it may not be entirely unrealistic because last year the disinvestment target was exceeded with the government selling ₹85,045 crore of public sector equity against a target of ₹80,000 crore.

The main issue here is that a large part of the public enterprise equity sold by the government is often bought by other public enterprises, such as the public sector insurance companies with deep pockets. The criticism is that such disinvestment is purely cosmetic. It is not an asset sale from the public sector to the private sector as the term "disinvestment" would suggest. Instead, what the government is selling on the one hand, it is picking up on the other. In a typical transaction of this type, with the government selling its equity in public enterprise A to public enterprise B, nothing changes for enterprise A, except that in its ownership structure the government is now replaced by public enterprise B. Similarly, for enterprise B, nothing changes other than that a part of its investment portfolio consists of equity of enterprise A. However, the government has now monetised a part of its asset portfolio and these funds become available to help finance the deficit.

In the absence of these transactions, the government would have had to borrow more to finance its deficit. Its debt liability would have gone up and so also the interest burden. In other words, disinvestment even to another public enterprise has a very real and positive fiscal effect. If the disinvestment proceeds are spent to finance capital expenditure, that grows the productive asset portfolio of the government. But, if the disinvestment proceeds are used to mostly finance a revenue deficit, then a moot question arises whether selling capital assets to finance current government consumption is a prudent fiscal policy.

**Sovereign bonds:** A final point on capital receipts is about a controversial proposal to float sovereign foreign currency bonds to the tune of about ₹10,000 crore. With the total public sector borrowing requirement (PSBR) amounting to around 9% of the GDP, risk less government and parastatal domestic borrowing is crowding out private borrowing from not just the entire financial savings of the household sector (7% of the GDP, Chenoy 2019), but also a part of private corporate savings. With domestic bond yields remaining highly elevated and with exceptionally low global interest rates, the government has sought to shift a part of its borrowing requirement abroad to limit domestic crowding out, pointing out that its recourse to foreign borrowing would be very small.

However, India's dependence on private external capital flows is not small, taking into account foreign direct investment,

**Table 2: Receipts and Percentage Changes**

| | | 2016–17 (Actual) | 2017–18 (Actual) | 2018–19[1] (BE) | 2018–19[1] (PA) | 2019–20 (BE) | % Change | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | ₹ in crore | | | (PA) 2018–19/ BE 2018–19 | PA 2018–19/ Actuals 2017–18 | BE 2019–20/ PA 2018–19 |
| (0) | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) |
| (1) | Revenue receipts (3+10) | 13,74,203 | 14,35,233 | 17,25,738 (9.2) | 15,63,170 (8.3) | 19,62,761 | -9.4 | 8.9 | 25.6 |
| (2) | Tax revenue (gross) | 17,15,822 | 19,19,009 | 22,71,242 (12.1) | 20,80,203 (11.0) | 24,61,195 | -8.4 | 8.4 | 18.3 |
| (3) | Tax revenue (net to centre) | 11,01,372 | 12,42,488 | 14,80,649 (7.9) | 13,16,951 (7.0) | 16,49,582 | -11.1 | 6 | 25.3 |
| (4) | Direct tax[2] | 8,49,713 | 10,02,037 | 11,50,000 (6.1) | 1,140,421 (6.1) | 13,35,000 | -0.8 | 13.8 | 17.1 |
| (5) | Indirect tax[3] | 8,66,109 | 9,16,971 | 11,21,242 (6.0) | 9,39,782 (5.0) | 11,26,195 | -16.2 | 2.5 | 19.8 |
| (6) | Central GST | | 2,03,262 | 6,03,900 (3.2) | 4,57,535 (2.4) | 5,26,000 | -24.2 | 125.1 | 15.0 |
| (7) | UT GST | | 1,635 | 2,530 (0.0) | 2,407 (0.0) | 2,768 | -4.9 | 47.2 | 15.0 |
| (8) | Integrated GST | | 1,76,688 | 50,000 (0.3) | 28,947 (0.2) | 28,000 | -42.1 | -83.6 | -3.3 |
| (9) | GST compensation cess | | 62,612 | 90,000 (0.5) | 95,081(0.5) | 1,09,343 | 5.6 | 51.9 | 15 |
| (10) | Non-tax revenue | 2,72,831 | 1,92,745 | 2,45,089 (1.3) | 2,46,219 (1.3) | 3,13,179 | 0.5 | 27.7 | 27.2 |
| (11) | Interest receipts | 16,229 | 13,574 | 15,162 (0.1) | 12,815(0.1) | 13,711 | -15.5 | -5.6 | 7 |
| (12) | Dividends and profits | 1,23,017 | 91,361 | 1,07,312 (0.6) | 1,13,424(0.6) | 1,63,528[4] | 5.7 | 24.1 | 44.2 |
| (13) | Non-debt capital receipts | 65,373 | 1,15,678 | 92,199 (0.5) | 1,02,885 (0.5) | 1,19,828 | 11.6 | -11.1 | 16.5 |
| (14) | Disinvestment of government equity | 47,742 | 1,00,045 | 80,000 (0.4) | 85,045 (0.5) | 1,05,000 | 6.3 | -15 | 23.5 |

1 Figures in parenthesis indicate percentage of GDP.
2 Direct tax includes income, corporate and other minor direct taxes. These are gross figures inclusive of states' share.
3 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.
4 This does not include post-budget transfer of RBI surplus.
BE: Budget estimates. PA: Provisional actuals.
Source: Actuals and budgeted estimates are collected from *Budget at a Glance* for 2018–19 and 2019–20; @ Provisional actuals are collected from monthly accounts (March 2018–19), Comptroller General of India.

portfolio investments of foreign financial institutions and external commercial borrowings by the private sector. Given the already existing exposure to foreign exchange risks, sovereign commercial borrowing abroad would set a dangerous precedent. It has been considered and rejected by policymakers several times in the past and there is no good reason to change that stance. At a minimum, if the government persists in going for external commercial borrowing, these should be fully hedged against foreign exchange risk. The government could also float domestic currency-denominated international bonds, so-called "masala" bonds. But, even these would have to be fully hedged against foreign exchange risk since lenders would immediately swap the rupee proceeds of such bonds on maturity. Once such hedging costs are taken into the reckoning, external borrowing may no longer be a particularly cheap option.

## Structure of Expenditure

The structure of planned expenditure in the 2019–20 budget estimates suggests a complacent "business as usual" approach with little indication of any major steps to deal with the growth deceleration and economic distress, especially in rural areas. As in the past, general services that mostly comprise of committed expenditures, continue to absorb nearly 43% of the budget (Table 3). Of these the single largest item is interest payments at 21.6%, followed by defence expenditure at 10%. This marks a significant decline in the share of defence from nearly 12% in 2016–17.

Among the other components, the neglect of social services continues with a total allocation of merely 4.4%. It can be argued that this reflects the constitutional assignment of responsibilities, in which social services mostly come under the state list in the Seventh Schedule of the Constitution (Lexis Nexis 2015). Indeed, the bulk of public spending on social services is undertaken by the states (Dev 2019). However, significant components of education and health services come under the concurrent list. Further, the allocation of subjects has never constrained the central government from undertaking expenditure on state subjects through the instrument of centrally sponsored schemes such as Sarva Shiksha Abhiyan, National Health Mission, etc. The low share of social services, therefore, is also a reflection of the low priority for public spending on social services in India.

Economic services are allocated the balance 37.3%, with the largest component being infrastructure—transport, communications, power and irrigation and flood control—that continues to absorb over 15% of total expenditure. Agriculture and rural development together get 12.8% of total expenditure, up from 11.8% last year. The share of agriculture that has gone up mainly because of the Pradhan Mantri Kisan Samman Nidhi (PM–Kisan) scheme that envisages providing ₹6,000 per year to all farmers. However, the allocation for the Mahatma Gandhi National Rural Employment Guarantee Act under rural development—a scheme mainly accessed by rural workers—has been compressed. If the goal of these schemes is to provide relief from intensifying rural distress, then some rationalisation is clearly called for.

## Deep Fiscal Adjustment

Deceleration is now quite severe with growth in Q1 of 2019–20 down to 5%, the lowest in six years. This is the consequence of strong expenditure compression in a challenging macroeconomic environment in 2018–19, when all the other demand-side drivers of growth were slowing down. As we have explained above, the expenditure shock last year will be followed by a similar negative expenditure shock in FY 2019–20 since actual expenditure has to be adjusted to the inevitable shortfall in highly optimistic revenue projections in order to keep the fiscal deficit in check. Indeed, there is little room to ease the fiscal deficit target, given the severe crowding out of private investment by a large PSBR of around 9% of GDP as against household financial savings of only 7%.

Clearly, not much can be done in a "business as usual" scenario. Much can

**Table 3: Expenditure and Allocations**

| | | ₹ in crore | | | | | Percent of Total Expenditure | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Actuals 2016–17 | Actuals 2017–18 | BE 2018–19 | RE 2018–19 | BE 2019–20 | Actuals 2016–17 | Actuals 2017–18 | BE 2018–19 | RE 2018–19 | BE 2019–20 |
| (0) | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) |
| 1 | Total expenditure (excluding loans and advances; debt repayments) | 21,82,490 | 24,65,201 | 27,53,587 | 28,11,641 | 31,14,973 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2 | General services* | 10,23,919 | 11,14,841 | 12,01,263 | 12,20,092 | 13,25,685 | 46.9 | 45.2 | 43.6 | 43.4 | 42.6 |
| 2.1 | Interest payment and servicing of debt | 5,04,512 | 5,43,707 | 5,90,795 | 5,99,992 | 6,73,471 | 23.1 | 22.1 | 21.5 | 21.3 | 21.6 |
| 2.2 | Defence services | 2,59,396 | 2,83,310 | 2,89,284 | 2,93,122 | 3,12,657 | 11.9 | 11.5 | 10.5 | 10.4 | 10.0 |
| 3 | Social services* | 98,254 | 1,06,335 | 1,16,804 | 1,19,620 | 1,38,381 | 4.5 | 4.3 | 4.2 | 4.3 | 4.4 |
| 3.1 | Education, sports, art and culture | 36,319 | 45,169 | 47,935 | 48,353 | 51,943 | 1.7 | 1.8 | 1.7 | 1.7 | 1.7 |
| 3.2 | Medical and public health | 16,186 | 20,505 | 20,668 | 22,826 | 28,607 | 0.7 | 0.8 | 0.8 | 0.8 | 0.9 |
| 4 | Economic services* | 7,58,328 | 8,50,562 | 9,97,117 | 10,64,207 | 11,62,955 | 34.7 | 34.5 | 36.2 | 37.9 | 37.3 |
| 4.1 | Agriculture and allied activities | 1,66,372 | 1,68,959 | 2,43,586 | 2,66,266 | 3,36,837 | 7.6 | 6.9 | 8.8 | 9.5 | 10.8 |
| 4.2 | Rural development | 49,433 | 57,036 | 57,886 | 63,520 | 63,354 | 2.3 | 2.3 | 2.1 | 2.3 | 2.0 |
| 4.3 | Irrigation and flood control | 1,284 | 2,212 | 4,500 | 2,896 | 3,637 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 |
| 4.3 | Energy | 50,886 | 49,160 | 51,305 | 49,431 | 63,572 | 2.3 | 2.0 | 1.9 | 1.8 | 2.0 |
| 4.5 | Transport | 2,87,924 | 3,00,750 | 3,40,561 | 3,32,066 | 3,63,725 | 13.2 | 12.2 | 12.4 | 11.8 | 11.7 |
| 4.6 | Communications | 37,785 | 37,874 | 42,253 | 38,530 | 43,230 | 1.7 | 1.5 | 1.5 | 1.4 | 1.4 |
| 5 | Grants-in-aid and contributions | 2,90,999 | 3,81,526 | 4,26,548 | 3,95,984 | 4,75,567 | 13.3 | 15.5 | 15.5 | 14.1 | 15.3 |
| 6 | Capital expenditure outside revenue account | 3,81,432 | 3,25,116 | 3,43,692 | 4,07,128 | 3,81,432 | 17.5 | 13.2 | 12.5 | 14.5 | 12.2 |

Expenditure data for row numbers 2 to 4.6 and 6 are net expenditure of the centre. BE: Budget estimates. RE: Revised estimates. *Subcategories under the item head are not exhaustive.
Source: Based on the annual financial statement.

be achieved, however, with deep fiscal adjustment of the kind proposed here.[5] The claim that there is no fiscal space is valid only in a "business as usual" scenario. Bold measures could in fact free up a large volume of fiscal space. Such adjustments cannot be accomplished within the remaining months of the current year. The measures proposed will have to be rolled out in a medium-term time frame of three to four years. However, we use the 2019–20 budget as a benchmark to illustrate a potential programme of deep fiscal adjustment.

First, there is much room for raising tax revenue substantially. The shortfall in tax revenue in 2018–19 was mainly on account of faulty administration of the GST and the incomplete electronic information system for this tax. Fixing this lacuna on a war footing could significantly contain the shortfall in indirect tax revenues. Further, revenue amounting to as much as 5% of the GDP is foregone on account of exemptions and concessions in both direct and indirect taxation (GoI 2019a). While the benefit of these tax expenditures for private interests is obvious what public interests these serve is quite unclear and unproven. Fixing the administrative-cum-information system for the GST and rolling back even half the tax expenditures would free up around 3% of the GDP as additional fiscal space even, without any increase in the rates of taxation.[6]

Rationalising expenditure is a third measure. We had earlier estimated that unwarranted non-merit subsidies amounted to 5.2% of GDP in 2011–12 (Mundle and Sikdar 2017). Our updated estimate shows that in 2015–16 these are slightly higher at 5.7% of the GDP (Mundle 2019). Eliminating even half these unwarranted subsidies could free up additional fiscal space of nearly 3% of the GDP. Finally, in its report on the accounts of the union government the Comptroller and Auditor General (2019) has indicated that there were savings due to excess appropriation amounting to around 1.5% of the GDP.

Thus, fiscal space amounting to over 12% of the GDP is currently being lost on inefficient GST administration, tax expenditures, unwarranted subsidies and excess appropriations. If these inefficiencies and misallocations could be pared down to even half their present volume, this would yield additional fiscal space amounting to over 6% of the GDP. However, this would obviously require very bold measures in the rationalisation and administration of both taxation and expenditures. The fiscal space so freed up would be more than adequate to finance an adjusted and expanded expenditure programme to revive growth without breaching the fiscal deficit target.

The main components of such a restructured and inclusive public expenditure would include the following:

(i) Income transfer under the PM–Kisan programme. Ghatak and Muralidharan (2019) have made a compelling case for extending the PM–Kisan programme to all citizens as an inclusive growth dividend (IGD) programme costed at 1% of the GDP. This programme should be further enhanced to assistance of ₹12,000 per citizen per year, costed and pegged at 2% of the GDP. The assistance per citizen would grow as the GDP grows.

(ii) Investments in key services like education, health and infrastructure. Education and health are particularly neglected in public spending programmes in India. Spending on infrastructure does get high priority. However, poor infrastructure is still a major supply-side constraint on growth. These services, education, health and infrastructure should each be allocated an additional 1% of the GDP in public expenditure.

(iii) Finally, the fiscal deficit must be compressed because the high PSBR is crowding out private investment and pulling down the investment rate. The remaining extra fiscal space of 1% of the GDP should be used to reduce the central fiscal deficit to 2.5% of the GDP, with a cap of 6% on the total PSBR.

## NOTES

1 Following the announcement of dividend transfer from the Reserve Bank of India (RBI) of ₹1,76,000 crore, as per the report of the Jalan Committee, the required growth in tax revenue and total revenue would amount to 20.9% and 21.1% respectively. This would only slightly moderate the required expenditure growth. The details underlying this computation are discussed below in Note 4.

2 As Chinoy (2019), Rao (2019) and others have argued the total public sector borrowing requirement (PSBR), including borrowing by the central government, state governments and central public sector undertakings (PSUs) actually amounts to almost 9% of the GDP. Probably more if state government PSUs are included in the reckoning, but comprehensive estimates of planned state PSU borrowing are not currently available.

3 Reported in *Indian Express,* 24 July 2019.

4 On 19 August 2019 the Reserve Bank of India (RBI) announced a transfer of ₹1,76,000 crore of dividend to the central government as per the Jalan Committee report. With ₹28,000 already having been transferred as interim dividend in the previous fiscal, the RBI dividend transfer in the current fiscal will amount to ₹1,48,000 crore as against the budget estimate of ₹90,000 crore, that is, an additional ₹58,000 crore (*Business Standard*, 28 August 2019). This additional non-tax revenue implies a corresponding reduction in the centre's required tax revenue to ₹15,91,582 crore and total revenue, adjusted for states share to ₹18,93,750 crore. This would entail a required growth of 20.9% and 21.1% in tax revenue and total revenue respectively over the provisional actuals for FY 2018–19.

5 We have adopted the phrase "deep fiscal adjustment" used earlier by Vijay Joshi (2016). Though the specifics of our proposal are somewhat different, the underlying idea is essentially the same: revenue and expenditure adjustments to revive inclusive growth.

6 Since these measures would increase tax revenue, though not the rates, it is useful to recall the balanced budget multiplier principle that even if an expenditure is fully financed out of tax revenue it has a net positive impact on aggregate demand.

## REFERENCES


Chinoy, S (2019): "A Pragmatic Balancing Act: Budget Does No Harm, But Fiscal Limits Must Be Confronted and Bold Choices Made," *Times of India,* 2 February.

Comptroller and Auditor General (2019): *Accounts of the Central Government,* No 2 of 2019.

Dev, M (2019): "Social Sector in the 2019 Union Budget," *Economic & Political Weekly,* Vol LIV, No 33, 17 August.

Ghatak, M and K Muralidharan (2019): *An Inclusive Growth Dividend: Reframing the Role of Income Transfers in India's Anti-poverty Strategy,* India Policy Forum, National Council of Applied Economic Research, 9 July.

GoI (2019): *Receipts Budget 2019–20 Annexe 7,* Ministry of Finance, Budget Division, Government of India.

— (2019a): *Press Note on Estimates of Gross Domestic Product for the First Quarter (April–June) 2019–20,* Ministry of Statistics and Programme Implementation, Government of India.

Joshi, V (2016): *India's Long Road: The Search for Prosperity,* London: Allen Lane, the Penguin Group.

Lexis Nexis (2016): *The Constitution of India*, 13th edition, 2015, Gurgaon, India: Lexis Nexis.

Mundle, S (2019): "Modifying the Nyontam Aay Yojana to Make it Workable," *Mint,* 19 April.

Mundle, S and S Sikdar (2017): "Budget Subsidies of the Central Government and 14 Major Indian States: 1987–88 and 2011–12," *Ideas for India*, 14 March, http://ideasforindia.in/article.aspx?article_id=1776.

NCAER (2019): *Quarterly Review of the Indian Economy,* National Council of Applied Economic Research, July.

Rao, M G (2019): "Road Map for Structural Reforms in Budget 2019: A Reality Check," *Economic & Political Weekly,* Vol LIV, No 33, 17 August.