Focus on Growth and Fiscal Consolidation*

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The economy has passed through successive shocks in the last three years posing difficulties in both growth and macroeconomic stability. Beginning with 2020-21, when the economy contracted by 6.6 per cent due to the successive waves of the pandemic, it barely staged a recovery to 8.7 per cent in the next year and close to 7 per cent in the current fiscal. The pandemic was followed by the Russia-Ukraine war, which had the effect of increasing energy and food prices and creating supply disruptions. With the slowdown in the global economy, raging inflation, and rising interest rates, there has been significant pressure on both inflation and exchange rate in India. Although the recovery has helped to reach the 2019-20 income level, it is still 7 per cent below the pre-pandemic trend. As much of the current year's 7 per cent growth is due to the base effect of the first two quarters and the second half of the year is likely to grow by just a little over 4.2 per cent, economic revival must get precedence in policies. Much remains to be done to revive the growth environment. In particular, there has been a secular decline in the investment-GDP ratio and the reversal of this is crucial to returning to the high growth trajectory. At the same time, a difficult global environment with world growth estimated at just 2.9 per cent by the IMF and one-third of the global economy set to face recession, the only functioning engine of growth is private consumption. In this situation, reviving growth by increasing public investment in infrastructure can help to spur private investment as well. At the same time, it is important to limit government borrowing, particularly when the household sector's financial saving is low, in order to avoid financial crowding out private investment.

There are some interesting features in the last four budgets presented by the present Finance Minister. First, the budgets have had much greater transparency than in the past as off-budget liabilities are included in the consolidated fund. Second, the budget have been much more realistic, in fact conservative, in their projection of revenues, and the actual deficits as a percentage of GDP have tended to be close. Third, there has been greater emphasis on increasing capital expenditures while continuing to undertake fiscal consolidation. The budget for 2023-24 follows this trend.

A significant increase in capital expenditure while continuing with fiscal consolidation is by no means, a small achievement. The capital expenditure in 2023-24 is budgeted to increase by over 37 per cent from Rs. 7.3 trillion to Rs. 10 trillion and this should crowd in substantial private investment. This is important at a time when the interest rates are high and foreign investment inflow is erratic. In fact, the increase comes on top of the 25 per cent increase in the capital expenditure last year and that should help to create a more congenial investment climate. Commercial banks' non-food

lending has already been on the rise and increased public spending on infrastructure should spur greater economic activity.

The revised estimate of fiscal deficit is placed at 6.4 per cent of GDP in spite of a sharp increase in revenue expenditures particularly on food and fertilizer subsidies. The food subsidy increased by Rs. 80000 crore as the government decided to extend subsidized foodgrains under both National Food Security Act and Pradhan Mantri Gram Kalyan Anna Yojana. Similarly, increase in fertilizer prices due to higher cost of feedstock increased the subsidy bill by Rs. 50000 crore. Not surprisingly the revenue deficit in nominal terms increased from Rs. 9.9 lakh crore to 11.1 lakh crore and fiscal deficit increased from Rs.16.6 lakh crore to Rs. 17.6 lakh crore. However, better than budgeted buoyancy in tax revenue by Rs. 1.6 trillion and higher than assumed nominal growth of GDP has helped to contain the deficit at the budgeted 6.4 per cent of GDP. In other words, had the GDP estimate remained at the level assumed in the budget last year, the fiscal deficit would have been 6.8 per cent.

Another important feature of the budget is the focus on fiscal consolidation With an aggregate fiscal deficit (Centre and states) of about 10 per cent of GDP, and with the low household sector financial saving, there is not much borrowing space for private investment. The Finance Minister had laid the fiscal consolidation path which requires the Centre to bring down the fiscal deficit to 4.5 per cent by 2025-26. It is budgeted to reduce the deficit from 6.4 per cent to 5.9 per cent next year. The budget assumes a conservative increase of 10.5 per cent in nominal GDP and the tax revenue is estimated to increase by 11.7 per cent. The buoyancy works out to 1.14 which is quite realistic. In fact, much of the adjustment is budgeted to come from the expenditure side and the revenue expenditure is budgeted to increase just by one per cent of GDP. A significant reduction is estimated to come from the compression of food and fertilizer subsidies. The food subsidy is estimated to be lower by Rs. 90000 Crore mainly as the PMGKAY has been withdrawn and fertilizer subsidy is estimated Rs. 50000 crore due to the lower price of fertilizers. The current transfers to the states as a percent of GDP also will remain virtually stagnant at 3.3 per cent of GDP. In some sense, it would have been better to frontload the fiscal consolidation because the remaining reduction of 1.4 per cent age point to GDP in the next two years may not be easy as the general elections are slated next year.

The tax proposals in the budget are not very significant. There is some tinkering is customs duties but the overall stance remains protectionist. On personal income tax, the attempt is to incentivize the taxpayers to embrace the new tax regime but increase in the number of tax brackets takes us back to the pre-reform era when there were as many as 12 brackets!

***** Views are personal.***

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