Datt & Sundharam's

# Indian Economy UPDATES 2019

72ND EDITION

# Union Budget from 2015–16 to 2019–20

Supplement

## An Analysis

## HIGHLIGHTS

- Framing Economic Developments and Concerns for Recent Budgets
- Key Features of Union Budgets: FY 2015–16 through FY 2019–20
- An Assessment of the Union Budgets

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# Union Budget from 2015–16 to 2019–20

## An Analysis

The Union Budget is an important instrument of public policy as it sets out how the Central Government will raise resources and how it will spend them. Even in a federal fiscal framework such as that enshrined in the Indian Constitution, the Central Government budget is of special significance in shaping fiscal policy. In recent years, the Centre's share in consolidated spending of both the Central and State Governments has been around 40%. The powers of taxation are also more heavily vested with the Centre, and taxes levied by the Centre are shared with the States guided by the recommendations of the Finance Commissions.[1] The States's own tax revenue in recent years has only been around a third of the consolidated tax receipts of the Centre and the States (MoF, 2018, *Economic Survey 2017–18*, Volume II). The Union Budget thus has an important role in determining overall fiscal policy for the country.

On July 5, 2019, the Minister of Finance of the newly re-elected National Democratic Alliance (NDA) government presented the first Union Budget for 2019–20. This followed the Interim Budget of February 1, 2019, presented by the then Interim Minister of Finance before the general elections of May 2019. While the Interim Budget was not presented as a "vote on account" but more like a full budget,[2] with the elections only a few months away, its status was however uncertain since budget execution for the most part would have fallen in the hands of the next elected government. With the massive mandate received by the NDA at the general elections, there was thus much anticipation regarding the first Union Budget of the government's second term.

The following discussion reviews the latest Union Budget for the fiscal year (FY) 2019–20, but does so jointly with a review of the earlier budgets of the first term of the NDA government. The discussion is intended to offer an overall perspective and assessment of the broader experience of the Central Government's fiscal policy post-2014–15.

Every budget comes with its own set of framing economic developments. The challenge for budgetary policy is to be able to respond to the immediate concerns raised by such developments while also addressing issues of longer-term fiscal reform and the country's development priorities. In practice, the balancing act gets further overlaid with a variety of short-term political considerations that shape budget formulation. Before discussing how recent budgets have measured up to this challenge, it is useful to review in this section the main framing economic developments and issues that have contextualized these budgets.

### 1. FRAMING ECONOMIC DEVELOPMENTS AND CONCERNS FOR RECENT BUDGETS

It has been customary for every Finance Minister's Budget Speech since FY 2015–16 to begin by noting that India is "a bright spot" in the world economic landscape. The Union Budget of FY 2019–20 was no exception. The Budget Speech noted: "Our economy was at approximately US$ 1.85 trillion when we formed the Government

[1] A significant recent change has been the introduction of the Goods and Services Tax (GST) in 2017 whose administration is governed by the GST Council comprising the Union Finance Minister and the Finance Ministers of each State.

[2] In terms of constitutional legality, there is no express restriction on what can or cannot be included in an interim budget, so long as it is presented before the election dates are announced. The limits if any are more a matter of constitutional convention than one of constitutional rule. Indeed, the Constitution does not even use the words full or interim budget. There is a separate provision for a "vote on account" that allows grants in advance for government expenditures for a part of the financial year. However, unless the government chooses to present a "vote on account", there is no explicit restriction on what policy announcements can be included in the budget.

in 2014. Within 5 years it has reached US$ 2.7 trillion…. The Indian economy will grow to become a 3-trillion dollar economy in the current year. It is now the sixth largest in the world. Five years ago, it was at the 11th position. In Purchasing Power Parity terms, we are in fact, the 3rd largest economy already, only next to China and the USA." The Speech also went on to expound the vision of the 5 trillion dollar economy: "…it is well within our capacity to reach US$ 5 trillion in the next few years."

There is no doubt that the recent growth experience of the Indian economy has been impressive by international standards. Over the five years since 2014–15, India's economy has grown at about 7% per year (Table 1). Over this period (2014–15 to 2018–19), India has also done reasonably well in terms of the key indicators of macroeconomic stability relating to inflation, fiscal deficit, current account deficit and foreign exchange reserves (see Table 1). Inflation has moderated to under 4% and is within the band of inflation targeting by the Reserve Bank of India. The Central Government's fiscal deficit has been contained to an average of 3.7% of GDP over the 5-year period, current account deficit has also been moderate averaging around 1.4% of the GDP, and foreign exchange reserves averaged about US$ 382 billion, offering a comfortable cover for both imports and some volatility in foreign capital flows.

The self-congratulatory tone of the recent budget speeches, customary as it has been, should however be tempered by the fact that rapid growth of the Indian economy has not been limited to the last five years. The NDA government in 2014 inherited an economy with an already significant growth momentum. For instance, the average rate of growth for the five years up to 2014–15 was also around 7%. The celebration of economic growth should also be tempered by the vulnerabilities and new challenges that have arisen on several fronts over the last five years, as we discuss below.

**Table 1: Recent Economic Performance**

| Item | Percentage change (April–March) | | | | | Average over the 5 years |
|---|---|---|---|---|---|---|
| | 2014–15 | 2015–16 | 2016–17 | 2017–18 | 2018–19 | |
| GDP at Market Prices# | | | | | | |
| (a) at current prices | 11.0 | 10.5 | 11.5 | 11.3 | 11.2 | 11.1 |
| (b) at 2011–12 Prices | 7.4 | 8.0 | 8.2 | 7.2 | 6.8 | 7.5 |
| Index of Industrial Production (2011–12 = 100)* | 2.6 | 3.8 | 5.5 | 4.4 | 3.6 | 4.0 |
| Wholesale Price Index (2011–12 = 100) | 1.3 | – 3.7 | 1.7 | 2.9 | 4.3 | 1.3 |
| Consumer Price Index–Combined (2012 = 100) | 5.8 | 4.9 | 4.5 | 3.6 | 3.4 | 4.4 |
| Money Supply (M3) | 10.9 | 10.1 | 6.9 | 9.2 | 10.5 | 9.5 |
| Imports at Current Prices (in US$ million) | – 0.5 | – 15.0 | 0.9 | 21.1 | 10.4 | 3.4 |
| Exports at Current Prices (in US$ million) | – 1.3 | – 15.5 | 5.2 | 10.0 | 8.7 | 1.4 |
| | **Level (US$ billion)** | | | | | |
| Trade Balance | – 144.9 | – 130.1 | – 112.4 | – 160.0 | – 180.3 | – 145.6 |
| Current Account Balance | – 26.9 | – 22.2 | – 14.4 | – 48.7 | – 57.3 | – 33.9 |
| Foreign Exchange Reserves (end of FY) | 341.6 | 360.2 | 370.0 | 424.5 | 412.9 | 381.8 |
| | **As % of GDP** | | | | | |
| Fiscal Deficit as % of GDP | 4.1 | 3.9 | 3.5 | 3.4 | 3.4 | 3.7 |
| Current Account Deficit as % of GDP** | – 1.3 | – 1.1 | – 0.5 | – 1.5 | – 2.7 | – 1.4 |

***Note:*** # GDP figures for 2017–18 and 2018–19 are provisional.
* April–November for 2014–15, 2015–16 and 2016–17 with 2004–05 as base year.
** For the years 2014, 2015, 2016, 2017 and first-half of FY 2018–19.

***Source:*** Macroeconomic Framework Statements, 2015–16, 2016–17, 2017–18, 2018–19 and 2019–20, Ministry of Finance; the Reserve Bank of India; and International Monetary Fund, Balance of Payments Statistics Yearbook.

## 1.1 Deceleration of Economic Growth and "Decoupling"

The Central Statistics Office's (CSO) recent estimates indicate that the Indian economy has been slowing down since 2016–17. Real GDP growth fell from 8.2% in 2016–17 to 7.2% in 2017–18, and a further fall to 6.8% for 2018–19 (Figure 1). Real Gross Value Added (GVA) growth —sometimes considered a better measure of growth—shows a similar deceleration from 7.9% in 2016–17, to 6.9% in 2017–18, to 6.6% in 2018–19. The stalling of the growth momentum of the economy has clearly been an important framing issue for the last three budgets.

It is also pertinent to note that there is some concern regarding the second revised GDP and GVA estimates for 2016–17. Compared to the first revised estimates released by the CSO in 2018, there is a significant upward revision of the GDP and GVA growth rates for 2016–17. As against the first revised estimates of 7.1% growth in both GDP and GVA for 2016–17, the second revised estimates put these at 8.2% and 8.0% respectively. This makes 2016–17—the year of demonetization —the highest growth year since 2011–12. This seems to be at odds with other evidence on the impact of demonetization on economic activity (more on this later).

India's growth engine started sputtering in 2017–18 at a time there was a revival of world economic growth, leading the *Economic Survey 2017–18* to describe it as a temporary "decoupling" of India's growth from global growth. The *Economic Survey* noted several factors contributing to the deceleration and decoupling, including India pursuing a relatively tighter monetary policy[3], the economic shock induced by demonetization and the introduction of GST, the cumulative effects of non-performing assets of the banking sector, and the sharp upturn in global oil prices. Some of these are discussed further later.

The economic slowdown has been particularly marked throughout FY 2018–19 and the first quarter of FY 2019–20 (Figure 1). The following notes the proximate sources of the slowdown over the last four years up to FY 2018–19 and more specifically over the last five quarters up to Q1: 2019–20.

### *Slowdown over the Four Years: 2015–16 to 2018–19*

**(*a*) *Led by manufacturing, several major sectors of the economy contributed to the economic slowdown:*** The sectoral decomposition of growth

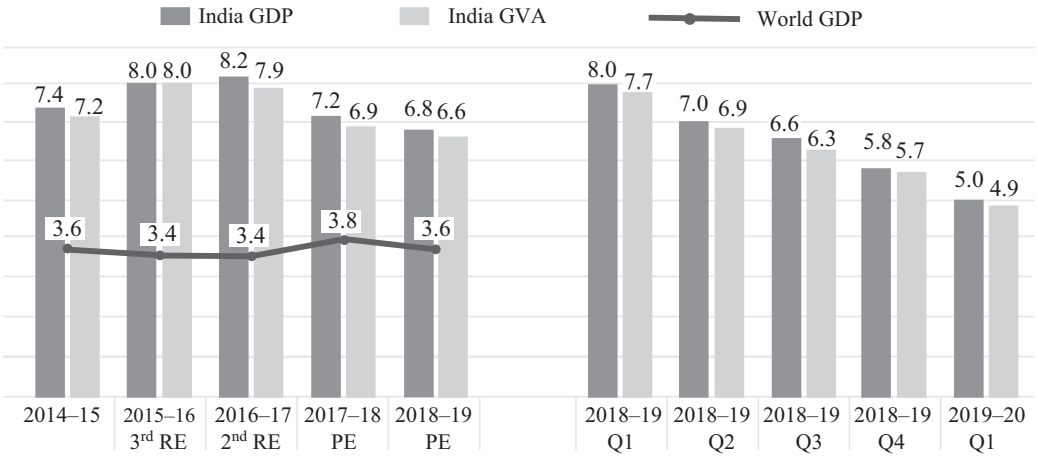


**Figure 1: Recent Growth Performance.**

***Note:*** RE: Revised Estimates; PE: Provisional Estimates. The growth rates for Q1–Q4 are on a year-on-year basis.
***Source*:** CSO (2019a, b), NSO (2019a) and IMF, World Economic Outlook Database.

[3] The monetary policy stance of the RBI was arguably less accommodative than the central banks of several advanced countries. However, whether India pursued a tighter than needed monetary policy remains a matter of debate. Except for two brief increases in the interest rates during 2018 (that were reversed by April 2019), the RBI has been cutting interest rates repeatedly since 2014.

sheds light on which sectors have contributed to the growth slowdown. As noted above, GVA growth slowed down by 1.4 percentage points between 2015–16 and 2018–19. The last column of Table 2 shows a breakdown of this 1.4 percentage point deceleration by economic sectors. It is evident from the Table that the manufacturing sector has contributed most to the slowdown, accounting for 1.0 of the 1.4 percentage point decline. The manufacturing growth rate fell sharply from nearly 13% in 2015–16 to 6% in 2017–18 before recovering a little to 7% in 2018–19. Financial, real estate and professional services sector and the trade, hotels, transport, communication and broadcasting services sector have been the second largest contributor to the economic slowdown, each contributing 0.6 percentage points to the slowdown. These three sectoral groups together account for about 60% of the total GVA. Thus, it is fair to say that most of the economy slowed down during this period.

**(*b*) *Private consumption remains the main source of demand, but falling net exports are draining aggregate demand amidst looming uncertainties in external environment*:** When looked at from the perspective of an expenditure breakdown of the GDP, private consumption is still by far the largest component of GDP with an average share of around 56% since 2011–12 up to 2018–19. It thus continues to be the main source of growth in national output on the demand-side contributing, for instance, 4.5 percentage points of the 6.8% GDP growth during 2018–19 (Table 3). Recent increases in government consumption, especially in 2017–18, have also been important in propping up aggregate demand. The contribution of public spending to growth is also evident from Table 2 in the rapid growth of public administration, defence and other services (especially during 2017–18)—reflecting in large part the pay hikes following the Seventh Pay Commission (for public sector wages) and the revised One Rank One Pension (OROP) scheme for the defence forces. Investment (Gross Fixed Capital Expenditure) has also positively contributed to growth. However, an area of weakness has been

**Table 2: Growth Rates by Sectors and their Contribution to Overall Growth of GVA: 2015–16 to 2018–19**

| Sector | Growth over previous year (%) | | | | Contribution to growth (% points) | | | | Contribution to deceleration between 2015–16 and 2018–19 |
|---|---|---|---|---|---|---|---|---|---|
| | 2015–16 | 2016–17 | 2017–18 | 2018–19 | 2015–16 | 2016–17 | 2017–18 | 2018–19 | |
| | [A] | [B] | [C] | [D] | [E] | [F] | [G] | [H] | [H] – [E] |
| 1. Agriculture, Forestry & Fishing | 0.6 | 6.3 | 5.0 | 2.9 | 0.1 | 1.0 | 0.8 | 0.4 | 0.3 |
| 2. Mining & Quarrying | 10.1 | 9.5 | 5.1 | 1.3 | 0.3 | 0.3 | 0.2 | 0.0 | – 0.3 |
| 3. Manufacturing | 13.1 | 7.9 | 5.9 | 6.9 | 2.3 | 1.4 | 1.1 | 1.2 | – 1.0 |
| 4. Electricity, Gas, Water Supply & Other Utility Services | 4.7 | 10.0 | 8.6 | 7.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.1 |
| 5. Construction | 3.6 | 6.1 | 5.6 | 8.7 | 0.3 | 0.5 | 0.5 | 0.7 | 0.4 |
| 6. Trade, Hotels, Transport, Communication & Services Related to Broadcasting | 10.2 | 7.7 | 7.8 | 6.9 | 1.9 | 1.5 | 1.5 | 1.3 | – 0.6 |
| 7. Financial, Real Estate & Professional Services | 10.7 | 8.7 | 6.2 | 7.4 | 2.3 | 1.9 | 1.4 | 1.6 | – 0.6 |
| 8. Public Administration, Defence and Other Services | 6.1 | 9.2 | 11.9 | 8.6 | 0.8 | 1.1 | 1.5 | 1.1 | 0.4 |
| GVA at Basic Price | 8.0 | 7.9 | 6.9 | 6.6 | 8.0 | 7.9 | 6.9 | 6.8 | – 1.4 |

***Note:*** Growth rates are at constant 2011–12 prices. The figures for 2015–16 are 3rd Revised Estimates, for 2016–17 are 2nd Revised Estimates, for 2017–18 and 2018–19 are Provisional Estimates.

***Source:*** Calculated from CSO (2019a, b), NSO (2019a).

**Table 3: Growth in Sources of Demand for GDP and their Contribution to Overall GDP Growth: 2015–16 to 2018–19**

| Sector | Growth over previous year (%) | | | | Contribution to growth (% points) | | | | Contribution to deceleration between 2015–16 and 2017–18 |
|---|---|---|---|---|---|---|---|---|---|
| | 2015–16 | 2016–17 | 2017–18 | 2018–19 | 2015–16 | 2016–17 | 2017–18 | 2018–19 | |
| | [A] | [B] | [C] | [D] | [E] | [F] | [G] | [H] | [H] – [E] |
| Government Final Consumption Expenditure | 7.5 | 5.8 | 15.0 | 9.2 | 0.7 | 0.6 | 1.5 | 1.0 | 0.2 |
| Private Final Consumption Expenditure | 7.9 | 8.2 | 7.4 | 8.1 | 4.5 | 4.6 | 4.2 | 4.5 | 0.1 |
| Gross Fixed Capital Formation | 6.5 | 8.3 | 9.3 | 10.0 | 2.0 | 2.6 | 2.9 | 3.1 | 1.1 |
| Net Exports* | 28.4 | 13.3 | −39.9 | −97.4 | 0.8 | 0.4 | −1.3 | −1.8 | −2.6 |
| GDP | 8.0 | 8.2 | 7.2 | 6.8 | 8.0 | 8.2 | 7.2 | 6.8 | −1.2 |

***Note:*** * includes change in stocks, valuables and discrepancies. Growth rates are at constant 2011–12 prices. The figures for 2015–16 are 3rd Revised Estimates, for 2016–17 are 2nd Revised Estimates, for 2017–18 and 2018–19 are Provisional Estimates.

***Source:*** Calculated from CSO (2019a, b), NSO (2019a).

net exports. The large decline in net exports during 2017–18 and 2018–19 has been a significant drag on aggregate demand, with net exports becoming a major contributor to growth deceleration on the demand-side (Table 3).

The negative (demand-side) contribution of net exports to growth is a combination of stagnation in exports and a sharp rise in imports following the spurt in international crude oil prices since 2016. As seen in Table 4, the dollar value of exports has stagnated since 2011–12; it plummeted during 2015–16 and 2016–17, and the subsequent recovery has only brought it back to the levels comparable to those observed earlier in the decade. Imports on the other hand have been closely following the trajectory of crude oil prices, falling up to 2016–17 and rapidly rising since then with the uptake in global oil prices. The recent rapid increase in the import bill together with stagnating exports has led to a significant worsening of the trade balance, and to a lesser extent also of the current account balance.

There has also been a significant shift in the global economic environment, with the United Kingdom's still unresolved exit from the European Union, the withdrawal of the US from the Trans–Pacific Partnership (TPP) agreement, and the recent US-China trade war with some risk of reciprocal protectionist actions by other countries. The recent rise in the US dollar is also likely to

**Table 4: Trade and Current Account Balance** (*US$ billion*)

| | Exports | Imports | Trade balance | Net invisibles | Current account balance |
|---|---|---|---|---|---|
| 2011–12 | 309.8 | 499.5 | –189.8 | 111.6 | –78.2 |
| 2012–13 | 306.6 | 502.2 | –195.7 | 107.5 | –88.2 |
| 2013–14 | 318.6 | 466.2 | –147.6 | 115.3 | –32.3 |
| 2014–15 | 316.5 | 461.5 | –144.9 | 118.1 | –26.9 |
| 2015–16 | 266.4 | 396.4 | –130.1 | 107.9 | –22.2 |
| 2016–17 | 280.1 | 392.6 | –112.4 | 98.0 | –14.4 |
| 2017–18 | 309.0 | 469.0 | –160.0 | 111.3 | –48.7 |
| 2018–19 | 337.2 | 517.5 | –180.3 | 123.0 | –57.3 |

***Note:*** Net invisibles include services, income and transfers. Data for 2018–19 are preliminary estimates and for 2017–18 are partially revised.

***Source:*** Reserve Bank of India: Database of Indian Economy (https://dbie.rbi.org.in/DBIE/ ).

accentuate the existing international protectionist pressures (besides adding to India's import bill). This shrinkage of the "political carrying capacity for globalization" presents new risks for India's future export growth that could further constrain the contribution of external demand to future economic growth.

### *Rapid Slide in Growth over the Last Five Quarters: Q1 2018–19 to Q1 2019–20*

The decline in economic growth has been particularly marked since the first quarter of FY 2018–19 (Figure 1). Growth rates of GDP by quarters on a year-on-year basis show a continuous slide: from 8.0% (Q1: 2018–19), to 7.0% (Q2: 2018–19), 6.6% (Q3: 2018–19), 5.8% (Q4: 2018–19) and 5.0% (Q1: 2019–20). GVA growth rates show a similar slide from 7.7% (Q1: 2018–19) to 4.9% (Q4: 2019–20). This continuous and substantial slide in growth over five successive quarters is beginning to look ominous. Table 5 tracks the proximate sources of the large slowdown from Q1 2018–19 to Q1 2019–20 is also substantial from 8% to 5% in GDP, and 7.7% to 4.9% in GVA, both in terms of economic sectors and sources of demand.

Two points about the recent economic slowdown are obvious from Table 5. First, it has been led by the massive slide in manufacturing. Growth in GVA in manufacturing was 12% in Q1: 2018–19, but by Q1: 2019–20, the manufacturing sector is at a near standstill, with growth down

**Table 5: Decomposition of Economic Slowdown by Economic Sectors and Sources of Demand: Q1: 2018–19 to Q1: 2019–20**

| | Growth over previous year (%) | | Contribution to growth (% points) | | Contribution to deceleration between Q1: 2018–19 and Q1: 2019–20 |
|---|---|---|---|---|---|
| | Q1: 2018–19 | Q1: 2019–20 | Q1: 2018–19 | Q1: 2019–20 | |
| **By Economic Sector** | | | | | |
| 1. Agriculture, Forestry & Fishing | 5.1 | 2.0 | 0.7 | 0.3 | −0.4 |
| 2. Mining & Quarrying | 0.4 | 2.7 | 0.0 | 0.1 | 0.1 |
| 3. Manufacturing | 12.1 | 0.6 | 2.1 | 0.1 | −2.0 |
| 4. Electricity, Gas, Water Supply & Other Utility Services | 6.7 | 8.6 | 0.2 | 0.2 | 0.0 |
| 5. Construction | 9.6 | 5.7 | 0.8 | 0.5 | −0.3 |
| 6. Trade, Hotels, Transport, Communication & Services Related to Broadcasting | 7.8 | 7.1 | 1.5 | 1.3 | −0.1 |
| 7. Financial, Real Estate & Professional Services | 6.5 | 5.9 | 1.6 | 1.4 | −0.2 |
| 8. Public Administration, Defence & Other Services | 7.5 | 8.5 | 0.9 | 1.0 | 0.1 |
| **GVA at Basic Price** | **7.7** | **4.9** | **7.7** | **4.9** | **−2.7** |
| **By Source of Demand** | | | | | |
| 1. Private Final Consumption Expenditure (PFCE) | 7.3 | 3.1 | 4.1 | 1.8 | −2.4 |
| 2. Government Final Consumption Expenditure (GFCE) | 6.6 | 8.8 | 0.8 | 1.0 | 0.3 |
| 3. Gross Fixed Capital Formation (GFCF) | 13.3 | 4.0 | 4.2 | 1.3 | −2.8 |
| 4. Net Exports* | −135 | −353 | −1.1 | 0.9 | 2.0 |
| **GDP** | **8.0** | **5.0** | **8.0** | **5.0** | **−2.9** |

***Note:*** * includes change in stocks, valuables and discrepancies. Growth rates are at constant 2011–12 prices.

***Source:*** Calculated from NSO (2019b).

to 0.6%. Thus, manufacturing alone accounts for 2 of the 2.7 percentage point fall in the overall GVA growth, or over 70% of the growth deceleration. Second, on the demand-side, private consumption and gross fixed capital formation (investment) have been the major contributors to the deceleration. Private consumption slowed down from a growth rate of 7.3% in Q1: 2018–19 to just 3.1% in Q1: 2019–20, while investment growth fell from 13.3% to 4%. With the massive dive in the two biggest components of demand (together accounting for 88% of aggregate demand), it is not surprising that the economy has slowed down to the extent it has.

## 1.2 Weakness in Private Investment Activity and Credit Growth

A continuing area of concern has been the prolonged weakness in investment activity. There was a continued decline in the overall investment ratio [the ratio of gross fixed capital formation (GFCF) to GDP] from 34.3% in 2011–12 to 30.8% in 2016–17 (Figure 2). There were some green shoots of recovery since 2017–18. However, by the fourth quarter of FY 2018–19, the aggregate GFCF ratio had fallen back to the 2015–16 level of 30.7%, well below the 34% level attained in 2011–12 and 2012–13.

Figure 2 also shows that changes in the overall investment ratio mainly follow the trend in private investment. Public investment throughout this period has remained between 7% and 8% of GDP. Thus, the weakness in investment mainly reflects the weakness in private investment.

Trends in several related indicators reinforce the picture of persisting weakness in private investment. For instance, according to the RBI's Order Books, Inventories and Capacity Utilization Survey (OBICUS), capacity utilization in manufacturing has been flat since March 2014 at about 75–76% (well below the peak of 83% in 2010–11); see Figure 3. Similarly, gross bank credit outstanding to industry by Scheduled Commercial Banks (SCBs) has also been flat since March 2015 at ₹26–28 trillion, following a period of rapid growth during 2009–14. The growth in bank credit to industry plummeted from an annual growth of over 20% during March 2008–March 2012 to negative growth during the year ending March 2017, less than 1% growth in the year ending March 2018 and a more recovered though still relatively low growth of under 7% for the year ending March 2019. Over the five years spanning March 2014 to March 2019, the average bank credit growth to industry has been a mere 2.8%. Note further

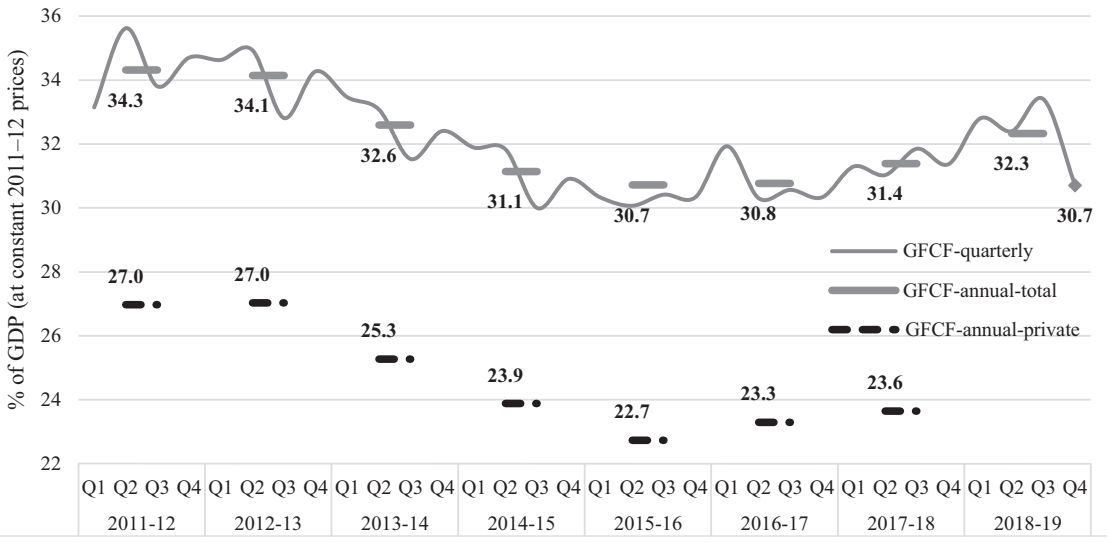


**Figure 2: Gross Fixed Capital Formation (as % of GDP) on Quarterly (Year-on-Year) and Annual Bases.**

***Note:*** GFCF-private refers to gross fixed capital formation in the private corporate and the household sector.

***Source:*** Based on CSO (2019a, b), NSO (2019a) and CSO data for earlier years.

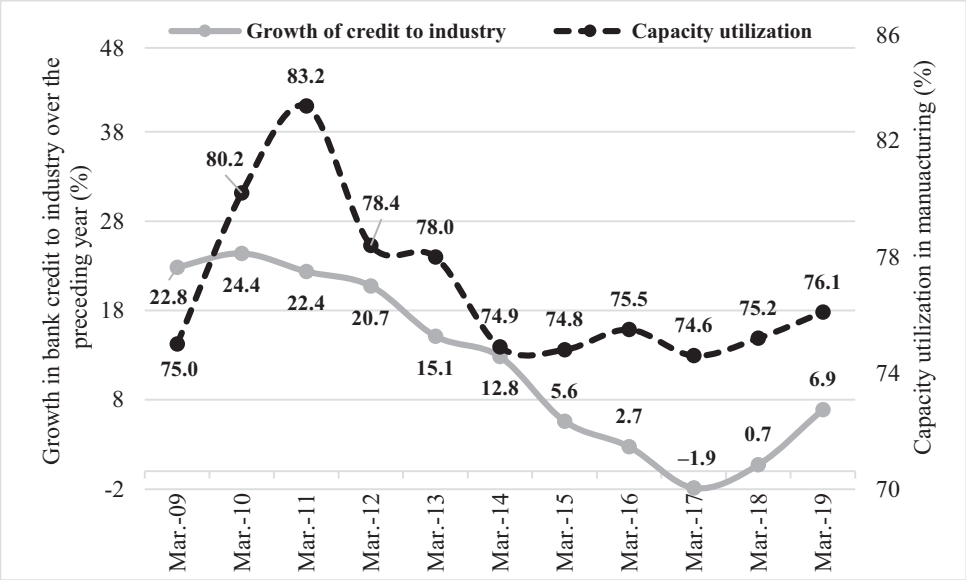


**Figure 3: Credit to Industry and Capacity Utilization in Manufacturing.**

***Note*:** The Figure shows outstanding credit to industry by Scheduled Commercial Banks in nominal terms. Capacity utilization measure is from on the RBI's Order Books, Inventories and Capacity Utilization Survey (OBICUS) of 800–1200 manufacturing companies.

***Source:*** RBI.

that this is in nominal terms and stands in sharp contrast to the rapid rise in nominal GDP that has been growing annually at over 10% over this period.

Not unrelated to this, the non-performing assets of Scheduled Commercial Banks (SCBs) have been on a rising trajectory for several years, increasing from a low of about 2% of total advances in 2009–10 to about 8% in 2015–16. More recently, the Gross Non-Performing Advances (GNPA) ratio of SCBs climbed further to 9.2% in September 2016, 10.2% in September 2017 and 11.5% in March 2018, before moderating a little to 10.1% in December 2018. Large borrowers with total exposure of ₹50 million or more accounted for 55% of gross advances and 83% of GNPA of SCBs in September 2018 (*RBI Financial Stability Report*, December 2018, RBI, 2018a)).[4] Thus, both the corporate and the banking sectors are under continued stress, and this is ultimately reflected in sluggish private investment—what the *Economic Surveys* of 2016–17 and 2017–18 referred to as "the festering twin balance sheet problem".

In recent years, there has also been rapid growth in Non-Banking Financial Companies (NBFCs) as a source of commercial credit. However, the September 2018 default by the Infrastructure Leasing & Finance Services Limited (IL & FS) suggests that NBFCs have not reduced the aggregate vulnerability of the financial system, but may have simply shifted it to another front.[5] It is even arguable that in view of their lighter regulation relative to banks as well as their strong links with the banking sector, the rapid growth of NBFCs may have even enhanced systemic risks for the financial sector.

## 1.3 Despite Two Good Monsoons During 2016–17 and 2017–18, Rural Distress Remains High

The economic slowdown would have been larger but for the better agricultural performance

[4] The top 100 large borrowers (in terms of outstanding funded amounts) alone accounted for 16% of credit and 25% of GNPA of SCBs (RBI, 2017).

[5] The GNPA ratio of the NBFC sector itself has risen from 4.1% of gross advances in March 2015 to 6.1% in September 2018 (RBI, 2018a).

on account of two successive good monsoons during 2016–17 and 2017–18. As seen in Table 2, the agricultural sector in fact contributed to a small *increase* in the overall growth rate between 2015–16 and 2018–19. However, the growth in agriculture during 2016–17 and 2017–18 needs to be put in perspective. Coming on top of two successive drought years, the growth is less impressive than it may appear. And in 2018–19, agricultural growth rate is estimated to have again come down to 2.9%, which is also the average agricultural GVA growth over the five years up to 2018–19. This in turn is more or less the same as the long-run average agricultural growth of 2.8% since 1960. At this growth rate, it would take nearly two and a half decades for real value-added in the sector as a whole to double – a far cry from the promise of doubling farmers' income in five years announced by the NDA government early in its first term. The sector is yet to shake off its monsoon-dependency and the endemic problems of price and income volatility. As agricultural sector still accounts for 64% of employment of all usual status workers in rural areas[6], these problems have been an important source of rural unrest that has also spilled over into a growing number of farmer protests.[7]

## 1.4 Inflation within the RBI Target Range with Only Moderate Risks for Monetary Policy

After reaching a peak of about 6% in July 2016 (on year-on-year basis), headline CPI inflation steadily declined to under 2% in June 2017 before starting to climb up again (Figure 4). Thus, the average CPI inflation during 2015 was 4.9%, 5.0% during 2016, 3.3% during 2017, 4.0% during 2018 and 2.8% during the first six months of 2019. As also seen in Figure 4, changes in the general CPI have been driven primarily by food prices. Core CPI inflation (exclusive of food, fuel and light) has however remained sticky at around 5%, which may be more indicative of price trends beyond the short-term. It is notable that the rise

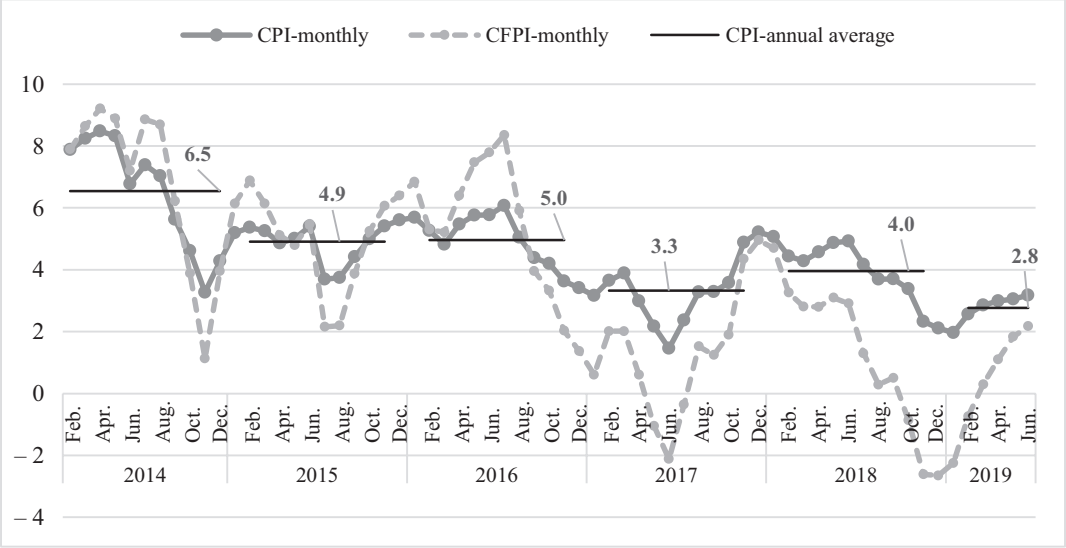


**Figure 4: General and Food Price Inflation, Monthly (Year-on-Year Basis) and Annual Average.**

***Note:*** The Figure plots percentage change in the Consumer Price Index (CPI-monthly) and the Consumer Food Price Index (CFPI-monthly) between the current month and the same month for the preceding year. It also plots the annual average CPI inflation rate (average over the first six months for 2019).

***Source:*** Based on data from the RBI.

[6] This estimate is for 2011–12 and is based on the Employment and Unemployment Survey of the NSSO (2013).

[7] By the National Crime Records Bureau data, the number of farmer protest rose from 628 in 2014, to 2683 in 2015, to 4837 in 2016 (Himanshu, 2018).

in inflation—both food and general—during June-December 2017 occurred despite a favorable monsoon.[8] The *Monetary Policy Report* of April 2018 (RBI, 2018b) attributed this to an unseasonal spike in prices of vegetables and the implementation of the 7th Pay Commission's Housing Rent Allowance (HRA) award which directly feeds into the CPI. Both food and general price inflation have been lower since then. Overall, during the January 2015–June 2019 period, inflation has generally remained within the RBI inflation targeting range of 4 ± 2% (Figure 4). While the rising global crude oil price, especially since July 2017 (with a delayed pass-through to domestic prices) and the recent hikes in the Minimum Support Prices pose some risks for monetary policy, the risks are moderate. The recent *Monetary Policy Committee Meeting* of August 2019 (RBI, 2019a) projects CPI inflation to be 3.5–3.7% for the second-half of FY 2019–20.

## 1.5 Demonetization and its Aftermath

On November 8, 2016, the Prime Minister announced the immediate demonetization of currency notes of ₹1,000 and ₹500 denominations, thereby rendering in one stroke 86.9% of all currency in circulation as non-legal tender. The old notes could be exchanged for new notes (of denominations ₹500 and ₹2,000) in small amounts or could be deposited in banks up to December 30, 2016 though subject to withdrawal restrictions. While the full economic impacts of a monetary policy shock of this magnitude are still being debated, there is little doubt that it slowed the growth momentum of the economy, which is still largely cash-based.[9] The estimates of the short-run impact have ranged from 0.25–0.50 percentage point (pp) (*Economic Survey 2016–17*, MoF 2017), 0.33 pp (Reserve Bank of India) to 1 pp (IMF) of GDP. The estimates of aggregate GDP impact however mask diversity across sectors and income groups. The impact on the very heavily cash-dependent informal sector, which accounts for about 42% of GVA and 82% of all employment, is likely to have been far more severe. Evidence from several micro-studies appears to confirm this.[10]

The remonetization process was completed by March 2018; currency in circulation reached the pre-demonetization level during the week ending March 9, 2018 (*Monetary Policy Report*: April 2018, RBI, 2018a). With this, the economy was expected to recover from the short-run economic disruption. Both the Ministry of Finance and the RBI have discounted persistent effects, but some residual lagged effects appear to have lingered on. While it is difficult to evaluate the counterfactual of what would have happened without demonetization, most observers agree that it did stall the growth momentum of the economy.

## 1.6 Goods and Services Tax (GST)

The other major policy development over this period was the introduction of the Goods and Services Tax (GST), which came into effect on July 1, 2017. It had long been in the making—no less than 13 years since it was proposed by the Kelkar Task Force on Implementation of the Fiscal Responsibility and Budget Management (FRBM) Act in July, 2004. The GST is a tax based on the Value-Added Taxation (VAT) principle levied on a comprehensive tax base with nationwide coverage of goods and services. It represents a major overhaul of the country's indirect taxation system, with the GST subsuming a wide variety of indirect taxes previously levied by the Central and State Governments. Two years into implementation, the GST is in many ways still in transition. But expectations from the GST have been high in terms of the four main goals of establishing a unified market, expansion of the tax base, better tax compliance and higher tax revenues. While it is still early to adequately assess its performance, there have been several concerns with both the design and implementation of GST that have

[8] There was disflation in food prices during the last two months of 2018, but that has been reversed during 2019.

[9] According to estimates in the Report of the Committee on Digital Payments (MoF, 2016a), 78% of all consumer payments are in cash. Other estimates, such as those by Price Waterhouse Coopers reported in the *Economic Survey 2016–17*, indicate that cash accounts for 98% of volume and 68% of the value of all consumer transactions (MoF, 2017).

[10] See for instance, Chaddha, et al. (2017), Krishnan and Seigel (2017), Mohan (2017) as well as several other studies referred to in Bhattacharya, et al. (2017) for Ranchi, Amritsar, Jaipur and Delhi.

implications for achieving these goals. Some of the key issues include:

(*a*) the multiplicity of tax rates (with the GST Council having gone for a 5–tax slab structure and outright exemptions), thus departing from the original "One Tax" vision; this can create economic distortions, increase complexity of the tax system, raise administrative costs as well as tax litigation;

(*b*) relatively high compliance costs (especially for smaller firms), with a regular GST registrant required to file 37 returns in a year and a registrant under the composition scheme required to file quarterly returns;

(*c*) the compliance costs being accentuated further by a continuing flurry of changes to GST design and rates;

(*d*) a slow clearance of tax refunds, with an accumulation of unpaid tax refunds threatening a liquidity squeeze for exporters and small operators.

As will be discussed later, the evidence on the expansion of the tax base and higher tax revenues due to GST thus far points to significant shortfalls in expected gains. Although a step in the right direction given the inefficiencies of the earlier indirect tax system, there is widespread recognition that the GST has caused at least a short-term disruption of economic activity (see Section 3 for further discussion).

### 1.7 Enduring Under-Provision of Public Services

Beyond these recent developments, there are also longstanding development and fiscal policy concerns, in particular, those related to the serious under-provision of public services in India, especially in education, health and infrastructure. Despite growth in absolute terms, India's public spending in these areas is one of the lowest amongst the BRICS (An Association of the five major national economics: Brazil, Russia, India China and South Africa) and emerging markets. Addressing this under-provision is not only vital for long-term growth, but also important in relation to the redistributive role of budgetary policy in addressing economic and social inequalities.

The above is not an exhaustive list of relevant developments and issues for fiscal policy in recent years. They nonetheless encompass key elements of the prevailing economic environment and concerns against which the recent Union Budgets may be assessed. Before turning to such an assessment, we will first look at the key features of the recent budgets. We will focus in particular on the four full-year budgets of the NDA government for FY 2015–16 through FY 2018–19 and the most recent interim budget and the full-year budget for FY 2019–20.

## 2. KEY FEATURES OF UNION BUDGETS: FY 2015–16 THROUGH FY 2019–20

We will discuss the key features of the recent Union Budgets under four main headings:

(*i*) Overall size of the budget, total receipts and fiscal deficits.

(*ii*) Financing of fiscal deficits.

(*iii*) Composition of expenditure (what the union government spends on), and

(*iv*) Composition of receipts (where the union government's revenues come from).

### 2.1 Overall Size of the Budget, Total Receipts and Fiscal Deficits

The first key feature of the budgets is its size as determined by the total expenditure planned or executed through the budget. While the nominal rupee expenditure allocations increase over time as the nominal size of the economy itself grows, it is more meaningful to assess the size of the budget in terms of budget expenditure as a proportion of GDP.

As seen from Table 6, the size of the Union Budget over the years 2014–15 to 2019–20 has remained more or less constant at 13% of GDP. Compared to this, the average size of the Union Budget for the preceding five years was around 15% of GDP, thus suggesting some decline in the size of the budgets under the NDA government. We later discuss this aspect of the budget further.

The second key feature of the budgets relates to the financing of expenditure through Central Government revenues, also shown in Table 6. Note that for the purposes of computing the fiscal deficit (the excess of expenditure over revenues), the

**Table 6: Size of Union Budgets**

| | | ₹ thousand crore | | | % of GDP | | |
|---|---|---|---|---|---|---|---|
| | | Total expenditure | Total non-debt receipts | Fiscal deficit | Total expenditure | Total non-debt receipts | Fiscal deficit |
| **Average 2009–10 to 2013–14** | **A** | **1299.2** | **839.0** | **460.2** | **14.8** | **9.5** | **5.3** |
| 2014–15 | A | 1663.7 | 1152.9 | 510.7 | 13.3 | 9.2 | 4.1 |
| 2015–16 | A | 1790.8 | 1258.0 | 532.8 | 13.1 | 9.2 | 3.9 |
| 2016–17 | A | 1975.2 | 1439.6 | 535.6 | 12.9 | 9.4 | 3.5 |
| 2017–18 | A | 2142.0 | 1550.9 | 591.1 | 12.5 | 9.1 | 3.5 |
| 2018–19 | BE | 2442.2 | 1817.9 | 624.3 | 12.8 | 9.6 | 3.3 |
| 2018–19 | RE | 2457.2 | 1822.8 | 634.4 | 12.9 | 9.6 | 3.3* |
| 2019–20 | BE | 2786.3 | 2082.6 | 703.8 | 13.2 | 9.9 | 3.3 |
| Average 2014–15 to 2019–20 | | 2135.9 | 1551.1 | 584.7 | 13.0 | 9.4 | 3.6 |
| **Excluding GST Compensation Cess** | | | | | | | |
| 2017–18 | A | 2079.4 | 1488.3 | 591.1 | 12.2 | 8.7 | 3.5 |
| 2018–19 | RE | 2367.2 | 1732.8 | 634.4 | 12.5 | 9.1 | 3.3* |
| 2019–20 | BE | 2677.0 | 1973.2 | 703.8 | 12.7 | 9.4 | 3.3 |

***Note*:** Total non-debt receipts include the net tax revenue of the Central Government, non-tax revenue and non-debt capital receipts. The Union Budget for any financial year (FY) presents three sets of numbers on receipts and expenditures of the Central Government: the budget estimates (BE) of for current FY, and the budget estimates (BE) and revised estimates (RE) for the just-finished FY. It is also customary to present the actual (A) receipts and expenditures from two financial years ago as audited by the Comptroller and Auditor General of India. The difference between revised/actual and budget estimates for an FY is a measure of the budget execution performance for that FY.

* This differs from the 3.4% figure for the fiscal deficit for 2018–19 (RE) reported in the Union Budget of 2019–20. This is because we use the slightly higher estimate of nominal GDP for 2018–19 as per the Provisional Estimates of GDP at current prices released by the CSO in May 2019.

***Source*:** Union Budget (Various Years), Ministry of Finance and CSO.

relevant concept of Central Government revenues is the government's total non-debt receipts, which have three main elements:

(*i*) Tax revenue (net to the Central Government, after excluding the share of the States).

(*ii*) Non-tax revenue receipts, and

(*iii*) Capital receipts of a non-debt nature (disinvestments and recoveries of loans).

As seen in Table 6, the Central Government's total non-debt receipts have ranged between 9.2% and 9.9% of GDP between FY 2014–15 and FY 2019–20, and have averaged about 9.4% of GDP. This is not very different to the 9.5% level for the preceding five years. Thus, on average, the revenue effort of the Central Government during the NDA tenure has not been very different to that during the preceding regime. On average during FY 2015–16 through FY 2019–20, non-debt receipts have been adequate to finance about 73% of Central Government expenditure.

The third key feature relates to the size of the resulting fiscal deficit as the difference between total expenditure and total non-debt receipts. While the average fiscal deficit during 2009–10 and 2013–14 was around 5.3% of GDP, this has successively come down since then to the current planned fiscal deficit of 3.3% of GDP for FY 2019–20. This fiscal consolidation has been a notable feature of the last five Union Budgets. We will take a further look at this in the following section.

The above is however subject to one caveat. Both the receipts and expenditure sides of the budget include an allowance for the GST Compensation Cess since FY 2017–18. This Cess is levied over and above the standard GST rate on certain specified luxury and demerit goods to compensate the States for any revenue loss on account of the implementation of GST. The Cess is transferred to a non-lapsable public account as

per the GST (Compensation to States) Act, 2017. As it appears on both the receipts and expenditure side of the budget, it is budget-neutral and does not have any bearing on the fiscal deficit. However, it inflates both the receipts and expenditures in the Union Budget. Excluding the Cess, the size of the Union Budget is smaller, with expenditure/GDP ratios of 12.2% for FY 2017–18 (A) and 12.5% for FY 2018–19 (RE) and 12.7% for FY 2019–20. The corresponding non-debt receipts/GDP ratios are 8.7%, 9.1% and 9.4% respectively for FY 2017–18 (A), FY 2018–19 (RE) and 2019–20 (BE).

## 2.2 Financing of Fiscal Deficits

Table 7 shows the sources of financing of fiscal deficits. The first feature to note is that there is little or no reliance on external debt; nearly all of the deficit is financed domestically. Traditionally, market borrowings through sale of dated securities and treasury bills issued by the Government of India have been the main channel for financing the fiscal deficit. In FY 2015–16, similar to earlier years, 85% of the fiscal deficit was financed through market borrowings. Since then, there has been a reduction in the share of market borrowings. For the three fiscal years 2016–17 to 2018–19, the average share of market borrowings was about 71%. In the Budget for FY 2019–20, it is planned to go down further to 64%.

The fall in the share of market borrowings reflects the effects of (*i*) a greater reliance on the drawing down of cash balances (especially for FY 2018–19 and FY 2019–20), and (*ii*) a greater resort to the National Small Savings Fund (NSSF) and other smaller savings. While the drawing down of cash balances is clearly not a sustainable source of finance, greater recourse to the NSSF

**Table 7: Financing of Fiscal Deficits**

| | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019–20 Budget Estimates | Average 2015–16 to 2019–20 |
|---|---|---|---|---|---|---|
| | (₹ thousand crore) | | | | | |
| **Fiscal Deficit** | 532.8 | 535.6 | 591.1 | 634.4 | 703.8 | 599.5 |
| ***Sources of finance:*** | | | | | | |
| **Debt Receipts (Net)** | | | | | | |
| 1. Market Borrowings (G-Sec and T-Bills) | 454.7 | 355.2 | 455.2 | 447.7 | 448.1 | 432.2 |
| 2. Securities against Small Savings | 52.5 | 67.4 | 102.6 | 125.0 | 130.0 | 95.5 |
| 3. State Provident Funds | 11.9 | 17.7 | 15.8 | 17.0 | 18.0 | 16.1 |
| 4. Other Receipts (Internal Debts and Public Account) | –12.2 | 86.1 | 5.4 | 8.4 | 59.5 | 29.4 |
| 5. External Debt | 12.7 | 18.0 | 7.9 | –4.9 | –3.0 | 6.2 |
| **Draw-Down of Cash Balance** | **13.2** | **–8.9** | **4.1** | **41.2** | **51.1** | **20.1** |
| | (% of fiscal deficit) | | | | | |
| **Fiscal Deficit** | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| ***Sources of finance:*** | | | | | | |
| **Debt Receipts (Net)** | | | | | | |
| 1. Market Borrowings (G-Sec and T-Bills) | 85.4 | 66.3 | 77.0 | 70.6 | 63.7 | 72.1 |
| 2. Securities against Small Savings | 9.8 | 12.6 | 17.4 | 19.7 | 18.5 | 15.9 |
| 3. State Provident Funds | 2.2 | 3.3 | 2.7 | 2.7 | 2.6 | 2.7 |
| 4. Other Receipts (Internal Debts and Public Account) | –2.3 | 16.1 | 0.9 | 1.3 | 8.5 | 4.9 |
| 5. External Debt | 2.4 | 3.4 | 1.3 | –0.8 | –0.4 | 1.0 |
| **Draw-Down of Cash Balance** | **2.5** | **–1.7** | **0.7** | **6.5** | **7.3** | **3.4** |

***Source:*** Union Budget (Various Years), Ministry of Finance.

may have some adverse consequences. First, there is a direct increase in the cost of government borrowing as interest rates on NSSF funds, which are administered to offer a committed return to subscribers, are typically higher than those for market borrowing. Second, while NSSF borrowing is intended to ease the pressure on market borrowings and, hence, keep the yield on government securities (the cost of market borrowing) in check, the economy-wide effect on market borrowings may not be substantial. This is because higher Central Government borrowing from NSSF comes at the expense of lower NSSF borrowing by states and, hence, the latter's greater resort to market borrowing. Third, small savings also compete with bank deposits. Higher small savings rates put an upward pressure on bank deposit (interest) rates which, in turn, could make bank lending more costly. These changes in the pattern of financing of fiscal deficits thus have implications not only for potentially higher interest payments on government debt, but also for the cost of credit for the private sector.

## 2.3 Composition of Expenditure

How has the government spent its budgetary resources over the last five budget cycles? Table 8 shows the allocations across major budget heads in rupee terms, while Table 9 show their shares in total expenditure.

While there is much anticipation about budget highlights every year, perhaps the main point to note about the composition of expenditures across the last five budgets is their remarkable stability. But for some variations that are noted below, the broad pattern of spending has changed little over the years. Focusing on the average composition of spending from FY 2015–16 through FY 2019–20 in Table 8 and 9, several key features of the spending pattern are notable:

(*i*) Most of the budgetary expenditure is of a revenue nature. Capital expenditure (including grants-in-aid for the creation of capital assets) only accounts for about one-fifth of total expenditure.

(*ii*) Two big claims on the Union Budget are interest payments, accounting for about 24% of the total expenditure, and defence, accounting for another 17%. Thus, these two items alone account for two-fifths of all Central Government spending. This is not a new phenomenon, but a longstanding feature of Central Government budgets. It is however notable that the share of interest payments has not declined despite the recent moderation of the fiscal deficit. For instance, in FY 2009–10 when fiscal deficit was 6.5% of the GDP, interest payments accounted for 21% of total expenditure. In FY 2018–19, with fiscal deficit at 3.4% of GDP, interest payments still accounted for 24% of total expenditure.

(*iii*) About 4–5% of the budget goes into Home and External Affairs, while transfers to States and Union Territories (other than transfers under Centrally Sponsored and Central Sector Schemes or through the States' share in centrally collected taxes) account for another 6–7%. The share of transfers to States and Union Territories rises to about 10% if the allocation for GST Compensation Cess is included (this is included under Tax Administration in Tables 8 and 9).

(*iv*) After the above claims on the budget are netted out, only less than half the Central Government budget is thus available for all other spending by the Central Government on economic and social development and the provision of other public goods and services. This basic feature of the expenditure allocation of the Union Budget has persisted for a long time, but is useful to bear in mind when considering how much of the budget is devoted to economic and social sectors directly addressing the development needs of the country.

(*v*) Among economic sectors, agriculture and allied activities have on average accounted for only 3% of total expenditure. Rural development accounts for 5.5% of total expenditure, while urban development, industry, commerce and finance together account for 4.4%. Transport accounts for 5.3% while energy, IT and telecom account for 2.4%.

(*vi*) Among social sectors, education, health, water and sanitation together account for 6.6% of total expenditure, while civil pensions and social welfare account for about 4%.

(*vii*) The above heads of expenditure thus account for nearly 84% of the budget. Of the remaining, about 10–11% is allocated to subsidies: about 6% for food (through the Public Distribution System), 3% for fertilizers, and 1% for petroleum (LPG and kerosene).

**TABLE 8: Composition of Expenditure in Union Budgets**

(₹ *thousand crore*)

| | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019–20 Budget Estimates | Average 2015–16 to 2019–20 |
|---|---|---|---|---|---|---|
| Interest and Debt Servicing | 441.7 | 480.7 | 529.0 | 587.6 | 660.5 | 539.9 |
| Defence | 293.9 | 351.5 | 379.7 | 405.2 | 431.0 | 372.3 |
| Home Affairs | 67.8 | 78.4 | 87.5 | 99.0 | 103.9 | 87.3 |
| External Affairs | 14.5 | 12.8 | 13.7 | 15.6 | 17.9 | 14.9 |
| Subsidy | | | | | | |
| *Food* | 139.4 | 110.2 | 100.3 | 171.3 | 184.2 | 141.1 |
| *Fertilizer* | 72.4 | 66.3 | 66.4 | 70.1 | 80.0 | 71.0 |
| *Petroleum* | 30.0 | 27.5 | 24.5 | 24.8 | 37.5 | 28.9 |
| Rural Development | 90.2 | 113.9 | 135.0 | 135.1 | 140.8 | 123.0 |
| Agriculture and Allied Activities | 23.7 | 50.2 | 52.6 | 86.6 | 151.5 | 72.9 |
| Urban Development | 20.2 | 36.9 | 40.1 | 43.0 | 48.0 | 37.6 |
| Commerce and Industry | 16.2 | 21.4 | 24.1 | 28.4 | 27.0 | 23.4 |
| Finance | 71.2 | 41.5 | 17.4 | 18.9 | 20.1 | 33.8 |
| Transport | 87.4 | 102.2 | 110.4 | 145.4 | 155.4 | 120.2 |
| Energy | 21.1 | 31.0 | 42.2 | 46.2 | 44.6 | 37.0 |
| IT and Telecom | 15.1 | 18.0 | 16.9 | 16.3 | 21.8 | 17.6 |
| Education | 67.2 | 72.0 | 80.2 | 83.6 | 94.9 | 79.6 |
| Health | 34.1 | 39.0 | 53.0 | 55.9 | 65.0 | 49.4 |
| Drinking Water and Sanitation | 11.1 | 16.5 | 23.9 | 20.0 | 20.0 | 18.3 |
| Civil Pensions | 36.5 | 43.6 | 53.7 | 59.8 | 62.2 | 51.2 |
| Social Welfare | 31.7 | 31.8 | 37.4 | 46.5 | 50.9 | 39.7 |
| Scientific Departments | 17.4 | 19.5 | 22.1 | 25.1 | 27.4 | 22.3 |
| Planning and Statistics | 6.0 | 4.5 | 4.6 | 5.4 | 5.8 | 5.2 |
| Others | 27.1 | 35.2 | 31.3 | 41.9 | 45.0 | 36.1 |
| Development of the North-East | 2.0 | 2.5 | 2.5 | 2.6 | 3.0 | 2.5 |
| Transfer to States | 114.8 | 132.7 | 107.5 | 141.4 | 155.4 | 130.4 |
| Union Territories | 11.8 | 13.3 | 14.2 | 14.1 | 15.1 | 13.7 |
| Tax Administration | 26.0 | 22.1 | 71.8 | 67.4 | 117.3<br>0.0 | 60.9 |
| **Total** | **1790.8** | **1975.2** | **2142.0** | **2457.2** | **2786.3** | **2230.3** |
| of which capital expenditure* | 384.8 | 450.3 | 454.2 | 516.9 | 545.9 | 470.4 |

***Note*:** Defence includes defence pensions. Drinking water and sanitation does not include the amounts for the *Swachh Bharat Mission* (Urban) which are included under Others. Tax administration includes GST Compensation Cess allocated to States for any revenue losses on account of GST implementation.

* Capital expenditure includes grant-in-aid for creation of capital assets.

***Source*:** Union Budget (Various Years), Ministry of Finance.

(*viii*) The rest—about 5–6% of total expenditure—is thinly spread over a large number of budget heads including housing, women and child development, youth affairs and sports, labour, employment and skill development, social justice and empowerment, tribal and minority affairs, Panchayati Raj, development of North Eastern Region, tax administration, science and technology, and environment, forests and climate change. It is notable that environment, forests and climate change including renewable energy only account for 0.5% of the total budget, while science and technology accounts for 1%.

**Table 9: Composition of Expenditure in Union Budgets**

(*% of total expenditure*)

| | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019–20 Budget Estimates | Average 2015–16 to 2019–20 |
|---|---|---|---|---|---|---|
| Interest and Debt Servicing | 24.7 | 24.3 | 24.7 | 23.9 | 23.7 | 24.3 |
| Defence | 16.4 | 17.8 | 17.7 | 16.5 | 15.5 | 16.8 |
| Home Affairs | 3.8 | 4.0 | 4.1 | 4.0 | 3.7 | 3.9 |
| External Affairs | 0.8 | 0.6 | 0.6 | 0.6 | 0.6 | 0.7 |
| Subsidy | | | | | | |
| *Food* | 7.8 | 5.6 | 4.7 | 7.0 | 6.6 | 6.3 |
| *Fertilizer* | 4.0 | 3.4 | 3.1 | 2.9 | 2.9 | 3.2 |
| *Petroleum* | 1.7 | 1.4 | 1.1 | 1.0 | 1.3 | 1.3 |
| Rural Development | 5.0 | 5.8 | 6.3 | 5.5 | 5.1 | 5.5 |
| Agriculture and Allied Activities | 1.3 | 2.5 | 2.5 | 3.5 | 5.4 | 3.1 |
| Urban Development | 1.1 | 1.9 | 1.9 | 1.7 | 1.7 | 1.7 |
| Commerce and Industry | 0.9 | 1.1 | 1.1 | 1.2 | 1.0 | 1.0 |
| Finance | 4.0 | 2.1 | 0.8 | 0.8 | 0.7 | 1.7 |
| Transport | 4.9 | 5.2 | 5.2 | 5.9 | 5.6 | 5.3 |
| Energy | 1.2 | 1.6 | 2.0 | 1.9 | 1.6 | 1.6 |
| IT and Telecom | 0.8 | 0.9 | 0.8 | 0.7 | 0.8 | 0.8 |
| Education | 3.8 | 3.6 | 3.7 | 3.4 | 3.4 | 3.6 |
| Health | 1.9 | 2.0 | 2.5 | 2.3 | 2.3 | 2.2 |
| Drinking Water and Sanitation | 0.6 | 0.8 | 1.1 | 0.8 | 0.7 | 0.8 |
| Civil Pensions | 2.0 | 2.2 | 2.5 | 2.4 | 2.2 | 2.3 |
| Social Welfare | 1.8 | 1.6 | 1.7 | 1.9 | 1.8 | 1.8 |
| Scientific Departments | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| Planning and Statistics | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Others | 1.5 | 1.8 | 1.5 | 1.7 | 1.6 | 1.6 |
| Development of the North-East | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Transfer to States | 6.4 | 6.7 | 5.0 | 5.8 | 5.6 | 5.9 |
| Union Territories | 0.7 | 0.7 | 0.7 | 0.6 | 0.5 | 0.6 |
| Tax Administration | 1.5 | 1.1 | 3.3 | 2.7 | 4.2 | 2.6 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |
| of which capital expenditure* | 21.5 | 22.8 | 21.2 | 21.0 | 19.6 | 21.2 |

***Note*: *** See note to Table 8.

***Source*:** Based on Table 8.

This broad pattern of expenditure has remained largely unchanged over the budgets for FY 2015–16 through FY 2019–20, with the exception of two notable changes: (*i*) the share of agriculture has been rising, while (*ii*) the share of petroleum and fertilizer subsidies has fallen. These changes need to be viewed in the context of the framing economic conditions, and we will discuss them in greater detail below in Section 3.

## 2.4 Composition of Receipts

As noted earlier, the overall resources raised to finance expenditures of the Central Government come from three broad sources: (*i*) tax revenues (net of states' share), (*ii*) non-tax revenue receipts, and (*iii*) non-debt capital receipts. The contributions of these three sources to total receipts of the Central Government over successive budget years are shown in Table 10. Several features of the composition of receipts are notable.

(*i*) On average, over the five years from FY 2015–16 to FY 2019–20, tax revenues have contributed about 79% of the Central Governments total non-debt receipts, non-tax revenues have contributed about 16% and non-debt capital receipts the remaining 6%. Thus, the Central Government has predominantly relied on tax revenues to finance its expenditures. While this has

**Table 10: Composition of Total Receipts of the Union Government**

| | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019020 Budget Estimates | Average 2015–16 to 2019–20 |
|---|---|---|---|---|---|---|
| | (₹'000 crore) | | | | | |
| **1. Tax Revenue (Net of States' Share)** | **943.8** | **1101.4** | **1242.5** | **1484.4** | **1649.6** | **1284.3** |
| **2. Non-tax Revenue** | **251.3** | **272.8** | **192.7** | **245.3** | **313.2** | **255.1** |
| Interest Receipts | 25.4 | 16.2 | 13.6 | 12.0 | 13.7 | 16.2 |
| Dividends and Profits | 112.1 | 123.0 | 91.4 | 119.3 | 163.5 | 121.9 |
| External Grants | 1.9 | 1.3 | 3.6 | 1.3 | 1.0 | 1.8 |
| Other Non-tax Revenue | 110.3 | 130.5 | 82.3 | 110.6 | 132.8 | 113.3 |
| Receipts of Union Territories | 1.5 | 1.8 | 1.9 | 2.1 | 2.1 | 1.9 |
| **3. Non-debt Capital Receipts** | **63.0** | **65.4** | **115.7** | **93.2** | **119.8** | **91.4** |
| Recovery of Loans and Advances | 20.8 | 17.6 | 15.6 | 13.2 | 14.8 | 16.4 |
| Disinvestment Receipts | 42.1 | 47.7 | 100.0 | 80.0 | 105.0 | 75.0 |
| **Total Non-Debt Receipts of Central Government (1 + 2 + 3)** | **1258.0** | **1439.6** | **1550.9** | **1822.8** | **2082.6** | **1630.8** |
| | (% of total non-debt receipts of Central Government) | | | | | |
| **1. Tax Revenue (Net of States' Share)** | **75.0** | **76.5** | **80.1** | **81.4** | **79.2** | **78.8** |
| **2. Non-tax Revenue** | **20.0** | **19.0** | **12.4** | **13.5** | **15.0** | **15.6** |
| Interest Receipts | 2.0 | 1.1 | 0.9 | 0.7 | 0.7 | 1.0 |
| Dividends and Profits | 8.9 | 8.5 | 5.9 | 6.5 | 7.9 | 7.5 |
| External Grants | 0.1 | 0.1 | 0.2 | 0.1 | 0.0 | 0.1 |
| Other Non-tax Revenue | 8.8 | 9.1 | 5.3 | 6.1 | 6.4 | 6.9 |
| Receipts of Union Territories | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| **3. Non-debt Capital Receipts** | **5.0** | **4.5** | **7.5** | **5.1** | **5.8** | **5.6** |
| Recovery of Loans and Advances | 1.7 | 1.2 | 1.0 | 0.7 | 0.7 | 1.0 |
| Disinvestment Receipts | 3.3 | 3.3 | 6.5 | 4.4 | 5.0 | 4.6 |
| **Total Non-debt Receipts of Central Government (1 + 2 + 3)** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |

***Source*:** Union Budget (Various Years), Ministry of Finance.

been an enduring feature of union government's resource mobilization effort, the reliance on tax revenues has been even higher during this five year period relative to the previous five years-from 2010–11 to 2014–15, when the share of tax revenues was 77%.

(*ii*) Moreover, the reliance on tax revenues has been generally increasing through the last five budget cycles itself, its share rising from 75% in FY 2015–16 to 79% in FY 2019–20.

(*iii*) This has mainly come at the expense of a declining share of non-tax revenues from about 20% to 15%, while the share of non-debt capital receipts (mainly disinvestment receipts) has remained largely stable at about 5–6%, except for FY 2017–18 which saw a doubling of disinvestment receipts.

(*iv*) Two main components of non-tax revenue are dividends and profits of public enterprises and other non-tax revenue, the latter mainly comprising of spectrum charges. Of these two components, other non-tax revenue has largely stagnated over the five-year period even in nominal rupee terms. Dividends and profits too have stagnated till FY 2018–19, though the budget estimates allow for a significant increase (by 37% in nominal terms) during FY 2019–20. Thus, the receipts from dividends and profits are projected to rise from about ₹119 thousand crore in 2018–19 (RE) to ₹163 thousand crore in 2019–20 (BE). Nearly three-fourths of this increase is on account of a significantly higher transfer of dividend/ surplus of the RBI and nationalized banks and institutions (increasing from ₹74 thousand crore in 2018–19 to ₹106 thousand crore in 2019–20, of which ₹90 thousand crore is budgeted as receivable as dividend from the RBI alone.

(*v*) How much of RBI's surplus should be transferred to the government has been a point of contention in recent times, leading to the setting up an Expert Committee to review the Economic Capital Framework of the RBI, following calls for higher payouts by the Ministry of Finance that were resisted by the RBI. The Committee submitted its report to the RBI in August 2019. While the RBI's realized equity was about 6.8% of its balance sheet, the report recommended a requirement between 5.5% and 6.5% (RBI, 2019 b).[11] In accepting the recommendations of the Committee, the RBI chose to maintain the realized equity at the lower limit of 5.5%, leading to an approved payout of ₹176 thousand crore to the government, of which ₹53 thousand crore is a transfer from the central bank's "surplus" capital. While the government has welcomed the transfer as it will help it improve its fiscal bottom line, there remain some concerns whether adequate reserves have been maintained in the contingent risk buffers of the RBI to cover its monetary, financial stability, credit and operational risks.

It is also useful to look at the evolution of gross tax revenue of the Central Government in further detail, as shown in Table 11. As mandated by the Constitution and as per the recommendations of the Finance Commissions, a fraction of the gross tax revenues are passed on to the States as their share of the divisible tax pool. Since FY 2015–16, following the recommendation of the Fourteenth Finance Commission, the State's share in gross tax revenue rose to a little over one-third from the earlier five-year average of about 28% during 2010–11 to 2014–15 (see bottom rows of Table 11).

Some notable changes in the composition of gross tax revenues have included the following.

(*i*) The most significant change relates to the introduction of the GST in July 2017 which has since displaced other indirect taxes. The service tax is displaced fully, while customs and excise duties have been partially displaced. Since 2017–18, the GST has emerged as one of the largest contributors to taxes raised by the Central Government, its share of 29% of gross tax revenue in FY 2018–19 (RE) almost at par with the 30% share of corporation taxes. However, it is notable that union excise and customs duties are still important for the Central Government, contributing about 17% of gross tax revenue in 2018–19 (RE) and 19% in 2019–20 (BE).

(*ii*) There has been a small increase in the overall share of indirect taxes in gross tax revenue, from an average of 45% during 2010–11 to 2014–15 to 48% during 2015–16 to 2019–20. This however conceals a substantial reduction in the share of customs duties from about 16% to 9%, while the share of indirect taxes net of customs has risen sharply from 29% to 39%.

[11] Realized equity refers to the component of RBI's economic capital comprising its Capital, Reserve Fund and risk provisions through the Contingency Fund and the Asset Development Fund.

**TABLE 11: Composition of Gross Tax Revenue**

| | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019–20 Budget Estimates | Average 2015–16 to 2019–20 | Average 2010–11 to 2014–15 |
|---|---|---|---|---|---|---|---|
| | (₹'000 crore) | | | | | | |
| **Gross Tax Revenue** | **1455.6** | **1715.8** | **1919.0** | **2248.2** | **2461.2** | **1960.0** | **1020.4** |
| ***Direct taxes*** | ***741.9*** | ***849.7*** | ***1002.0*** | ***1200.0*** | ***1335.0*** | ***1025.7*** | ***560.4*** |
| Corporation Tax | 453.2 | 484.9 | 571.2 | 671.0 | 766.0 | 589.3 | 360.3 |
| Taxes on Income | 287.6 | 364.6 | 430.8 | 529.0 | 569.0 | 436.2 | 199.3 |
| Wealth Tax | 1.1 | 0.2 | 0.1 | | | 0.3 | 0.9 |
| ***Indirect taxes*** | ***713.7*** | ***866.1*** | ***917.0*** | ***1048.2*** | ***1126.2*** | ***934.2*** | ***460.0*** |
| Customs | 210.3 | 225.4 | 129.0 | 130.0 | 155.9 | 170.1 | 162.1 |
| Union Excise Duties | 288.1 | 382.1 | 259.4 | 259.6 | 300.0 | 297.8 | 170.3 |
| Service Tax | 211.4 | 254.5 | 81.2 | 9.3 | | 111.3 | 124.8 |
| Goods and Services Tax (GST) | | | 442.6 | 643.9 | 663.3 | 350.0 | |
| – CGST | | | 203.3 | 503.9 | 526.0 | 246.6 | |
| – IGST | | | 176.7 | 50.0 | 28.0 | 50.9 | |
| – GST Compensation Cess | | | 62.6 | 90.0 | 109.3 | 52.4 | |
| Taxes of Union Territories | 3.9 | 4.1 | 4.7 | 5.3 | 6.9 | 5.0 | 2.8 |
| Less-States' Share | 506.2 | 608.0 | 673.0 | 761.5 | 809.1 | 671.6 | 284.5 |
| Less-Transfer to NCCF | 5.7 | 6.5 | 3.5 | 2.3 | 2.5 | 4.1 | 3.8 |
| **Net-Centre's Tax Revenue** | **943.8** | **1101.4** | **1242.5** | **1484.4** | **1649.6** | **1284.3** | **732.2** |
| | (% of gross tax revenue) | | | | | | |
| **Gross Tax Revenue** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |
| ***Direct taxes*** | ***51.0*** | ***49.5*** | ***52.2*** | ***53.4*** | ***54.2*** | ***52.3*** | ***54.9*** |
| Corporation Tax | 31.1 | 28.3 | 29.8 | 29.8 | 31.1 | 30.1 | 35.3 |
| Taxes on Income | 19.8 | 21.2 | 22.4 | 23.5 | 23.1 | 22.3 | 19.5 |
| Wealth Tax | 0.1 | | | | | | 0.1 |
| ***Indirect taxes*** | ***49.0*** | ***50.5*** | ***47.8*** | ***46.6*** | ***45.8*** | ***47.7*** | ***45.1*** |
| Customs | 14.4 | 13.1 | 6.7 | 5.8 | 6.3 | 8.7 | 15.9 |
| Union Excise Duties | 19.8 | 22.3 | 13.5 | 11.5 | 12.2 | 15.2 | 16.7 |
| Service Tax | 14.5 | 14.8 | 4.2 | 0.4 | 0.0 | 5.7 | 12.2 |
| Goods and Services Tax (GST) | | | 23.1 | 28.6 | 27.0 | 17.9 | |
| – CGST | | | 10.6 | 22.4 | 21.4 | 12.6 | |
| – IGST | | | 9.2 | 2.2 | 1.1 | 2.6 | |
| – GST Compensation Cess | | | 3.3 | 4.0 | 4.4 | 2.7 | |
| Taxes of Union Territories | 0.3 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| ***Indirect taxes net of customs*** | ***34.6*** | ***37.3*** | ***41.1*** | ***40.8*** | ***39.4*** | ***39.0*** | ***29.2*** |
| Less-States' Share | 34.8 | 35.4 | 35.1 | 33.9 | 32.9 | 34.3 | 27.9 |
| Less-Transfer to NCCF | 0.4 | 0.4 | 0.2 | 0.1 | 0.1 | 0.2 | 0.4 |
| **Net-Centre's Tax Revenue** | **64.8** | **64.2** | **64.7** | **66.0** | **67.0** | **65.5** | **71.8** |

***Note*:** CGST: Central Goods and Services Tax; IGST: Integrated Goods and Services Tax for Inter-State Supplies; NCCF: National Calamity Contingency Fund.

***Source*:** Union Budget (Various Years), Ministry of Finance.

(*iii*) The share of direct taxes in gross tax revenue has declined from an average of about 55% over 2010–11 to 2014–15 to about 52% over the five budget cycles of the NDA government. This too conceals opposite movements in the shares of corporation taxes and taxes on income. The share of the former has declined from 35% to 30% while there has been a modest increase in the share of the latter from 20% to 22%.

## 3. AN ASSESSMENT OF THE UNION BUDGETS

The budget as the main instrument of fiscal policy can be assessed from several different perspectives informed by both immediate and longer-term considerations. In assessing the Union Budgets of the last five years, the framing economic context as discussed above in section 1 is clearly important. But it is also important to bear in mind the broader objectives of fiscal policy. Besides promoting macroeconomic stability, fiscal policy has an important role in promoting economic growth, and it is also a key redistributive instrument for promoting economic and social equity to ensure that the growth process is inclusive. The following assessment of the recent budgets is informed by a perspective that recognizes these diverse roles of fiscal policy.

### 3.1 Sliding Targets of Fiscal Consolidation and Growth Deceleration

Through successive budgets, the NDA government has maintained that fiscal consolidation (lowering of fiscal deficits) has been the hallmark of its fiscal policy, claiming for instance that it has "always attached utmost priority to prudent fiscal management and controlling fiscal deficit".[12] In many ways, this has been a continuation of past commitment as embodied in the Fiscal Responsibility and Budget Management (FRBM) Act of 2003. Yet, the policy and practice of containing fiscal deficits can only be meaningfully assessed in light of the prevailing economic context. From this perspective, several points can be made about India's recent fiscal consolidation experience.

(*i*) The FRBM Act originated in the context of India's high fiscal deficits in the early 2000s. One should note here that what is at stake is not just the fiscal deficit of the Central Government, but the consolidated fiscal deficit of the Central and State Governments. As seen in Figure 5, the consolidated fiscal deficit of the government as a whole peaked at 10% of GDP in 2001–02, with central and state fiscal deficits of 6% and 4% of GDP respectively. A consolidated fiscal deficit of 10% of GDP was not only high by international standards, it also was unsustainable for the Indian economy. The passage of the FRBM Act sought to check this and, among other provisions, the Act set 3% of GDP as the fiscal deficit target for the union government to be achieved by 2008–09.[13]

(*ii*) Considerable progress towards fiscal consolidated was made over the five years following the passage of the FRBM Act under the UPA-I government, with union and state government fiscal deficits falling to 2.5% and 1.5% of GDP. The consolidated deficit reached a record low of 4.1% of GDP in 2007–08. Thus, the FRBM target of 3% union deficit was achieved in that year and, indeed, this is only year since 2003 that this target has been met. There was a reversal thereafter during initial years of the UPA-II government with the union fiscal deficit rising to around 5–6% over the years 2008–09 to 2011–12 (and the consolidated deficit rising to the 7–9% range). There was however a renewed push towards fiscal consolidation during 2012–13 and 2013–14, and when the NDA-I government assumed office in 2014, it started with a union fiscal deficit of 4.1% of GDP for 2014–15.[14] Though still above the FRBM 3% target (which in the Finance Bill of 2015 was deferred to 2017–18), union fiscal deficit by this time was well below the high levels observed in the early 2000s and the early 2010s.

[12] Budget Speech 2018–2019 of Arun Jaitley, Minister of Finance, February 1, 2018 (Ministry of Finance).

[13] The Act also prohibited the monetization of fiscal deficits by disallowing the purchase of primary issues of Central Government securities by the RBI after 2006.

[14] However, fiscal deficits of the state governments grew from 1.9% (in 2011–12) to 2.6% of GDP (2014–15), even as the union fiscal deficit fell from 5.9% to 4.1%.

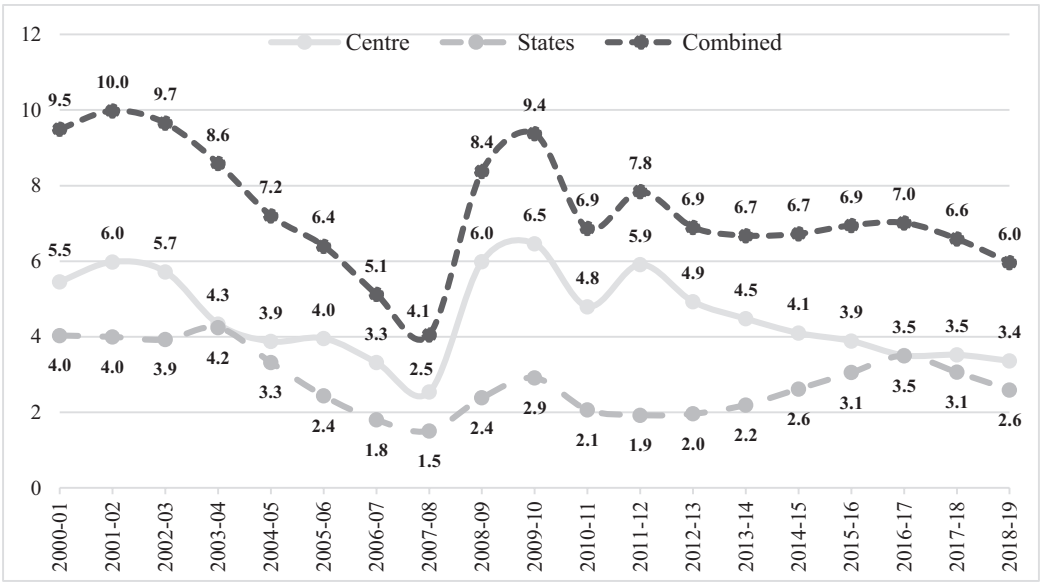


**Figure 5: Fiscal Deficits of Central and State Governments (as % of GDP).**

***Note:*** The figures for 2018–19 are Budget Estimates (BE).
***Source:*** Reserve Bank of India, *Database of the Indian Economy*.

(*iii*) The NDA-I government, especially after its first two years in office, found further fiscal consolidation to be difficult, and fiscal deficit targets have been sliding over successive budgets. For instance, the Medium Term Fiscal Policy (MTFP) Statement of 2015 envisioned that the target of 3% fiscal deficit would be achieved by 2017–18. MTFP 2017 moved this to 2018–19, and MTFP 2019 issued with the recent Budget for FY 2019–20 has further deferred this target to FY 2020–21 (see Figure 6).

(*iv*) The realized fiscal deficits have been higher than those in the anticipated glide path to fiscal consolidation, which itself has had to be revised in light of the deficits actually achieved. As is clear from Figure 6, achievements in fiscal consolidation are confined to the first two years of the NDA-I government. Over these two years, fiscal deficit was reduced from 4.1% of GDP in 2014–15 to 3.5% of GDP in 2016–17. Thereafter, further progress in fiscal consolidation has stalled. The Budget Estimate for FY 2019–20 projects the fiscal deficit at 3.3% of GDP. Even if this is achieved, in light of previous record, the FRBM target of 3% is likely to slip beyond 2020–21.

Is the slippage of fiscal consolidation targets a serious concern? In general, we know that large and persistent deficits can be a cause for concern due to their implications for private investment, interest and debt servicing obligations of the government and inflationary pressures in the economy. However, the level of concern crucially depends upon the degree of excess capacity in the economy. The negative consequences of fiscal deficits arise when the economy is operating at close to capacity, while in conditions of excess capacity fiscal deficits can help stimulate aggregate demand and economic activity (see Box 1). Thus, the "right" level of fiscal consolidation is contextually dependent and can be difficult to judge.

Relative to the FRBM target, the past budgets of the NDA-I government have done reasonably well in terms of fiscal consolidation. Fiscal deficits during the NDA-I regime (2014–15 to 2018–19) averaging 3.6% of GDP were lower than the average for the preceding five years of 5.3% of GDP (see Table 6). Similarly, the projected fiscal deficit of 3.3% for FY 2019–20 in the first Union Budget of the NDA-II government is arguably moderate. However, this apparently positive performance in fiscal consolidation needs to be qualified in three important respects.

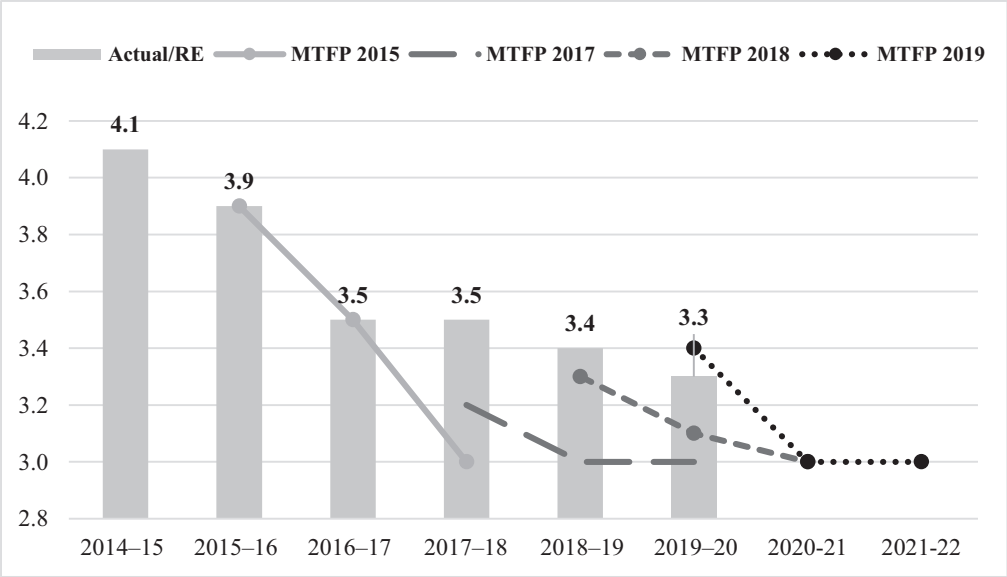


**Figure 6: Slipping Targets of Fiscal Consolidation (Fiscal Deficit as % of GDP).**

***Note:*** The 3.3% fiscal deficit for FY 2019–20 is as per Budget Estimates (BE).
***Source:*** Union Budget (Various Years), Ministry of Finance.

**Box 1: Why and When do Fiscal Deficits Matter?**

While there is nothing sacrosanct about a fiscal deficit of 3% of GDP as recommended by the Fiscal Responsibility and Budget Management (FRBM) Committee, large and persistent fiscal deficits can be a cause for concern.

There are several sources of concern. The first is what is often referred to as the *crowding out* effect and relates to the impact of fiscal deficits on private investment through higher interest rates. To appreciate how this works, note that the government primarily finances its deficit through market borrowings, i.e. by selling government securities. This effectively reduces the supply of funds available for borrowing by the private sector, which puts an upward pressure on real interest rates which, in turn has a dampening effect on private investment and economic growth. In the worst cases, there can be spiraling effects as slower growth increases pressures for fiscal expansion causing larger deficits which cause further reductions in investment and growth.

A second concern is that fiscal deficits raise public debt of the government. As public debt is primarily in the form of interest-bearing securities issued by the government, higher public debt raises the government's interest obligations on this debt. As noted in Section 2 above, interest payments and debt servicing have accounted for about a quarter of the total Central Government expenditure. This big claim on the budget comes at the expense of spending on other public services and developmental needs.

Third, fiscal deficits can also build up inflationary pressures if government spending does not sufficiently raise the economy's potential output. Fiscal slippage can thus put an added stress on monetary policy.

However, the risks of fiscal deficits can be overstated in an economic environment marked by excess capacity, insufficient demand and low and falling interest rates. Under these conditions, accommodative monetary policies of cutting interest rates can become increasingly blunt instruments for raising aggregate demand. In such an environment, the idea that we need deficit reduction to keep interest rates down and thus encourage borrowing and investment is hard to defend (Furman and Summers, 2019). On the contrary, there exists a case for stimulating demand through fiscal expansion.

### *Economic Disruption Due to Demonetization and GST*

One can argue that the room for further fiscal consolidation by the union government post-2016–17 was curtailed by the policy shock of demonetization in November 2016, which disrupted the growth momentum of the economy. As noted above, the estimates of the aggregate economic impact of demonetization vary between 0.25 and 1 percentage point of GDP. However, the impact of demonetization on the informal sector is likely to have been significantly more severe than the estimated economy-wide impact for both a structural reason and a statistical reason. The structural reason is that the informal sector, being far more heavily cash-based than the formal economy, bore the brunt of the supply-side shock of the liquidity squeeze. The statistical reason is that CSO's procedures for the estimation of the output of the informal sector rely on formal sector indicators. For instance, as noted by the *Economic Survey 2016–17*, "informal manufacturing is proxied by the Index of Industrial Production, which mostly [covers] large establishments." (MoF, 2017, pp. 73–74.) The economic slowdown of the informal economy is thus likely to have been considerably larger than what aggregate GDP/GVA estimates may suggest, and insofar as that is true, the aggregate economic impact itself is likely to have been underestimated.

Another source of economic disruption was the GST rollout in July 2017. Though a step in the right direction from the perspective of the reform of the indirect tax system, it nonetheless caused a disruption of supply chains, especially for small operators for whom the new system imposed significant compliance costs. This was amplified by a flurry of changes to the GST rate structure and procedures. While the disruptions due to GST may be viewed as inevitable short-term costs of a major tax reform (though these could have been mitigated by better design and implementation), no similar justification can be given for the disruption due to demonetization. In any event, these policy-induced disruptions contributed to the recent economic slowdown and constrained the scope for further fiscal consolidation.

### *Windfall Gains from Falling Oil Prices have Evaporated*

The reduction of fiscal deficits during the first two years of the NDA government was largely contingent on the falling international oil prices. During FY 2015–16 and FY2016–17, the government was enormously helped in the task of fiscal consolidation by the large windfall gains due to the dramatic decline in global oil prices since mid–2014. As seen in Figure 7, crude oil prices for the Indian basket fell from over US$100 per barrel in mid–2014 to under US$30 per barrel by end–2015. While the crude oil prices bottomed out in December 2015, they remained in the US$40–50 range for most of FY 2016–17.

The fall in global oil prices helped in two ways. On the revenue side, it allowed the government to increase excise on motor spirits and diesel, and on the expenditure side, it allowed a reduction in petroleum subsidies. Singh and Mate (2018) term this as the "terms of trade benefit" to the fiscal bottom line. Table 12 shows their estimates of this benefit. The benefit is estimated as the excess excise on petrol and diesel in these years above their long-term trend plus the saving in petroleum subsidies based on their elasticity to the oil price gap.

The terms of trade benefit arose as the lower global crude oil prices were not fully passed on to the consumers. As Table 12 shows, without this benefit, the fiscal deficit would have been 4% of GDP or higher in FY 2015–16, 2016–17 and 2017–18.

However, as also seen in Figure 7, crude oil prices for the Indian basket have been rising rapidly since June 2017, peaking at US$80 per barrel in October 2018 before moderating a little to around $62 per barrel by June 2019. Thus, the terms of trade benefit is likely to have turned negative in FY 2018–19 and beyond. It is hence not surprising that the government has found it difficult secure any further reductions in fiscal deficit once the rise in crude oil prices set in. As the *Economic Survey 2017–18* put it, global oil prices remain "India's historic macroeconomic vulnerability".

### *Growth Deceleration and Insufficient Aggregate Demand*

As discussed in Section 1, the growth momentum of the Indian economy has been stalling since FY 2016–17. The year-on-year

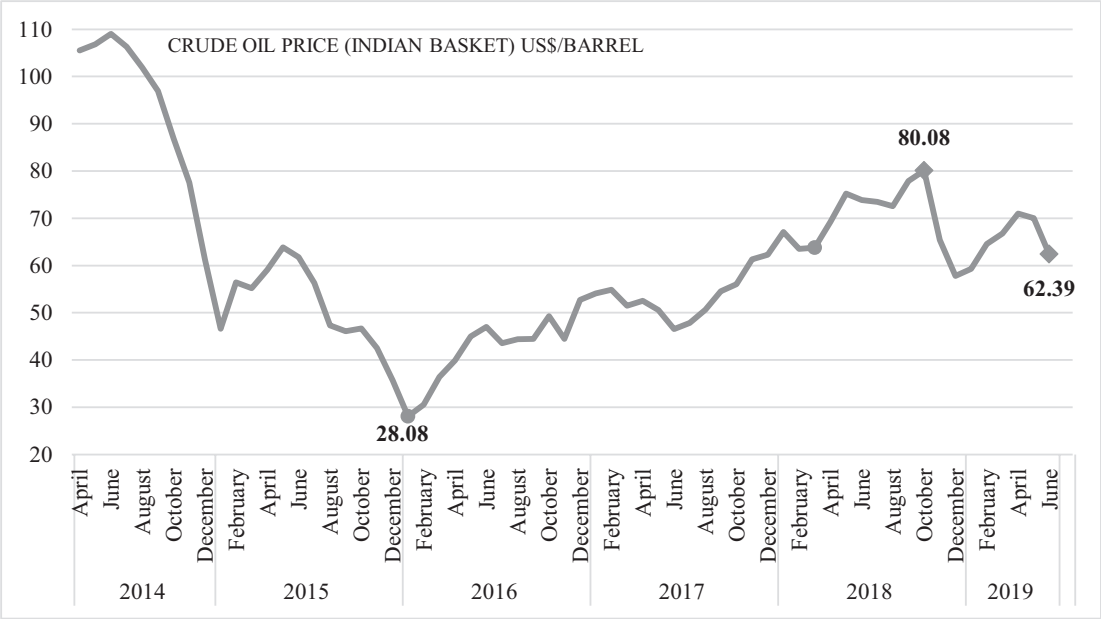


**Figure 7: Fall and Rise of Crude Oil Prices since 2014.**

***Source:*** Based on data from the Petroleum Planning and Analysis Cell (PPAC).

**Table 12: Fiscal Deficit With and Without the Terms of Trade Benefit of Petroleum Prices (% of GDP)**

| | 2015–16 | 2016–17 | 2017–18 (Revised Estimate) |
|---|---|---|---|
| Fiscal Deficit (Actual /Revised Estimate) | 3.93 | 3.51 | 3.54 |
| Terms of Trade Benefit | 0.32 | 0.62 | 0.48 |
| Fiscal Deficit without Terms of Trade Benefit | 4.25 | 4.13 | 4.02 |

***Source:*** Singh and Mate (2018).

growth rate has now fallen for five successive quarters from 8% in Q1 of 2018–19 to 5% in Q1 of 2019–20. Manufacturing sector growth is down to 0.6% in Q1 of 2019–10. Private consumption and investment have both decelerated. Unemployment reached at a 45–year high of 6.1% in 2017–18. Relative to 2011–12, both overall and youth unemployment rates in 2017–18 nearly tripled, while rates of labour force participation as well as employment fell (Table 13).

One would have to be in a state of denial not to recognize these signs of demand deficiency and excess capacity. The RBI has already cut interest rates four times during 2019. The Repo rate[15] was 6.5% before the first cut in February 2019 by 25 basis points; the fourth successive cut brought it down to 5.4% in August 2019.[16] The continuation of the growth slowdown despite the rate cuts suggests that an accommodative monetary policy has not been able to provide sufficient stimulus to

[15] The Repo rate is the rate at which the RBI lends to the commercial banks usually against government securities. It tends to act as a floor for bank lending rates, and although increases or decreases in repo rates may not be fully passed on to bank lending rates, the two tend to move together, making this an important instrument of monetary policy by which the RBI influences interest rates in the economy.

[16] The statutory liquidity ratio (SLR), which imposes limits on banks' lending capacity, was also reduced from 19.5% at the start of 2019 to 18.75% in July 2019. This follows a longer process of reduction of SLR by the RBI over several years, from 22.5% in June 2014, to 21% in July 2016, to 20% in June 2017 (RBI, *Database on Indian Economy*).

**Table 13: Unemployment, Labour Force Participation and Employment Rates, 2011–12 and 2017–18 (%)**

| | 2011–12 | 2017–18 |
|---|---|---|
| Unemployment rate–total | 2.2 | 6.1 |
| Youth (15–29) unemployment rate–male | 5.0 | 17.4 |
| Youth (15–29) unemployment rate–female | 4.8 | 13.6 |
| Labour force participation rate | 39.5 | 36.9 |
| Employment rate | 38.6 | 34.7 |

***Note:*** These are usual status (primary + secondary status) estimates.
***Source:*** Ministry of Statistics and Programme Implementation (MoSPI), 2019.

aggregate demand. Under these circumstances, there is a strong case for a fiscal stimulus, especially through public investment, even if that comes with a larger fiscal deficit. Current macroeconomic risks of a higher deficit appear to be low for at least three reasons. First, CPI inflation during the first-half of 2019 has been at a low of under 3% (see Section 1). Second, while there is some concern with adequate transmission of Repo rate cuts through the banking system, bank lending rates have generally been declining (see Figure 8). Third, there are definite indications of both excess capacity in the economy (see Section 1) as well as adequate liquidity in the banking system.[17] Under these conditions, higher public spending and investment (by stimulating demand) is more likely to crowd in rather than crowd out private investment.

It is also worth emphasizing that the FRBM target of a union fiscal deficit of 3% of GDP ought to be viewed as an average to be achieved over a number of years rather than a target that every budget must achieve. The latter would indeed substantially rule out the counter-cyclical function of fiscal policy—function that is highly relevant in the current environment of the economic slowdown.


**Figure 8: Prime Lending Rate since 2014 (% per annum).**

***Note:*** The prime lending rate is the average rate of interest charged on loans by five major banks.
***Source:*** Tradingeconomics.com and RBI.

[17] According to the analysis in RBI's recent *Monetary Policy Report*, "47 of the 54 banks in the sample will remain resilient in a scenario of assumed sudden and unexpected withdrawals of around 10 per cent of the deposits along with the utilisation of 75% of their committed credit lines" (RBI, 2019c).

## 3.2 Fiscal Consolidation through Expenditure Compression and Off-Budget Financing

Despite claims to the contrary, over the period FY 2015–16 through FY 2019–20, the main avenue for fiscal consolidation by the union government seems to have been expenditure compression rather than revenue growth. This becomes clearer if we look at the expenditure and receipts of the Central Government excluding the GST Compensation Cess since FY 2017–18. Note that the GST Compensation Cess is earmarked for a non-lapsable fund for compensating states for any revenue shortfall due to GST, and hence these funds are not available for Central Government spending. The amounts for this Cess are included on both the revenue and expenditure side of the union budget. While this has no bearing on the fiscal deficit, it artificially inflates the size of the budget. Table 14 presents the total expenditure and non-debt receipts of the Central Government excluding this Cess.

As seen in Table 14, the average fiscal deficit over the five years from 2009–10 to 2013–14 was 5.3% of GDP, while that for the five years from 2015–16 to 2019–20 was 3.5% of GDP. However, for the same periods, there was little change in the average non-debt receipts as a proportion of GDP; in fact, there was a small decline from 9.5% to 9.1% of GDP. Thus, rather than being revenue-led, the entire decline in fiscal deficit was realized on the strength of expenditure compression, with the expenditure-to-GDP ratio falling from 14.8% to 12.6%. Since expenditure compression has knock-on effects on the rest of the economy, there are obvious costs and limits to this path to fiscal consolidation.

In addition, there has been increasing resort to off-budget financing by the union government which renders the reported numbers on the fiscal deficit questionable. The recent report of the Comptroller and Auditor General (CAG) on the Compliance of the Fiscal Responsibility and Budget Management Act, 2003, for the Year 2016–17 drew attention to this (CAG, 2018). Off-budget financing is essentially in the nature of borrowings that become future liabilities of the government. As the CAG report notes, "… off-budget financing is a tool of deferring the expenditure for subsequent year(s) …Off-budget financing route being outside the parliamentary control, has implication for fiscal indicators, as they understate Government's expenditure in the year by keeping them off the budget." The CAG report notes:

> "Government has increasingly resorted to off-budget financing for revenue as well as capital

**Table 14: Total Expenditure and Non-debt Receipts in Union Budgets, Excluding GST Compensation Cess**

| | | ₹ thousand crore | | | % of GDP | | |
|---|---|---|---|---|---|---|---|
| | | Total expenditure | Total non-debt receipts | Fiscal deficit | Total expenditure | Total non-debt receipts | Fiscal deficit |
| Average 2009–10 to 2013–14 | A | 1299.2 | 839.0 | 460.2 | 14.8 | 9.5 | 5.3 |
| 2014–15 | A | 1663.7 | 1152.9 | 510.7 | 13.3 | 9.2 | 4.1 |
| 2015–16 | A | 1790.8 | 1258.0 | 532.8 | 13.1 | 9.2 | 3.9 |
| 2016–17 | A | 1975.2 | 1439.6 | 535.6 | 12.9 | 9.4 | 3.5 |
| 2017–18 | A | 2079.4 | 1488.3 | 591.1 | 12.2 | 8.7 | 3.5 |
| 2018–19 | RE | 2367.2 | 1732.8 | 634.4 | 12.5 | 9.1 | 3.3 |
| 2019–20 | BE | 2677.0 | 1973.2 | 703.8 | 12.7 | 9.4 | 3.3 |
| Average 2015–16 to 2019–20 | | 2177.9 | 1578.4 | 599.5 | 12.6 | 9.1 | 3.5 |

***Note:*** Total non-debt receipts include the net tax revenue (net of states' share), non-tax revenue and non-debt capital receipts of the Central Government. A: Actuals, RE: Revised Estimates, BE: Budget Estimates.

***Source*:** Union Budget (Various Years), Ministry of Finance.

spending. In terms of revenue spending, off-budget financing was used for covering deferring fertilizer arrears/bills through special banking arrangements; food subsidy bills/arrears of FCI (Food Corporation of India) through borrowings and for implementation of irrigation scheme AIBP (Accelerated Irrigation Benefits Programme) through borrowings by NABARD (National Bank for Agriculture and Rural Development) under the Long Term Irrigation Fund (LTIF). In terms of capital expenditure, off-budget financing of railway projects through borrowings of the IRFC (Indian Railway Finance Corporation) and financing of power projects through the PFC (Power Finance Corporation) are outside the budgetary control. Such off-budget financing are not part of calculation of the fiscal indicators despite fiscal implications." (CAG, 2018.)

In a presentation to the 15th Finance Commission in July 2019, the CAG noted that if off-budget borrowings for revenue and capital expenditure amounting to 0.96% and 1.43% of GDP respectively were taken into account, the real fiscal deficit for FY 2017–18 would be 5.85% of GDP relative to the reported deficit of 3.46%.

## 3.3 Revenue Shortfalls and Declining Buoyancy of Tax Receipts

How responsive have tax revenues been to income growth in recent years? A measure of this responsiveness is tax buoyancy calculated as the ratio of the proportionate increase in tax revenue to the proportionate increase in current price GDP (over the preceding year). Table 15 (Panel B) shows the tax buoyancy measures in recent years. For the two most recent years, 2018–19 and the budget estimates for 2019–20, the Table presents two sets of numbers. The first set in columns (4) and (5) uses the revised estimates for 2018–19 as presented in the Union Budget for 2019–20, while the second set in columns (6) and (7) uses the provisional actuals as reported by the Controller General of Accounts (CGA). The distinction is important in view of the fact that the CGA provisional actuals show that total non-debt receipts of the union government for 2018–19 have fallen short of the revised estimates in the Budget by ₹1.6 trillion representing 0.9% of GDP [Table 15 (Panel A)]. This is entirely on account of the shortfall in Gross Tax Revenues of ₹1.7 trillion (non-tax revenue and non-debt capital receipts were a little higher than the revised estimates). Most of the shortfall are on account of lower than anticipated collections from income taxes and indirect taxes (mainly GST); see Table 15 (Panel A).

The CGA actuals were also reported in the *Economic Survey* of *2018–19* released just prior to the Union Budget. This is a significant shortfall in tax revenues, and since the CGA estimates were already available, it is disingenuous of the government not to acknowledge and report these numbers in its Union Budget. In light of the above shortfall of the (provisional) actual revenues from the revised budget estimates for 2018–19, it is more appropriate to focus on the tax buoyancy measures based on the former. We may thus compare columns (1)–(3) in Table 15 (Panel B) with columns (6) and (7).

The evidence in Table 15, Panel B, shows that the responsiveness of tax revenues to income growth has significantly eroded since 2016–17. After reaching a high of 1.61 during 2015–16 and 2016–17, the buoyancy of gross tax revenue fell to 1.05 in FY 2017–18, further to just 0.75 in FY 2018–19. This is due to the rapid fall in the buoyancy of indirect tax[18] and income tax revenues since 2016–17. Note the buoyancy of indirect tax revenue during 2015–16 and 2016–17 was about 2.4, but fell to less than 0.4 in 2017–18 and 2018–19. The rapid plunge in buoyancy since 2016–17 illustrates (*i*) that the windfall gains from lower crude oil prices (as discussed above) were unsustainable, and (*ii*) that the expectation from the GST to substantially enhance indirect tax collections has not materialized. With multiple GST rates, product and threshold exemptions and compliance challenges, the GST has thus far failed to deliver the expected expansion of either the tax base or the tax revenues. The fall in the buoyancy of income taxes is harder to explain, but may in part reflect the accumulated refunds on income tax returns. Note that the fall in tax buoyancy comes as a double whammy: tax revenue growth is lower not only because the economy has been growing

[18] Recall that indirect taxes principally include the GST, customs and excise duties.

**Table 15 (Panel A): Revenue Shortfall in 2018–19**

| | 2018–19 RE | 2018–19 PA | Difference | 2018–19 RE | 2018–19 PA | Difference |
|---|---|---|---|---|---|---|
| | (₹trillion) | | | (% of GDP) | | |
| Gross Tax Revenue | 22.48 | 20.80 | −1.68 | 11.9 | 10.9 | −1.0 |
| Corporation tax | 6.71 | 6.64 | −0.07 | 3.6 | 3.5 | −0.1 |
| Income tax | 5.29 | 4.62 | −0.67 | 2.8 | 2.4 | −0.4 |
| Indirect taxes | 10.48 | 9.55 | −0.93 | 5.5 | 5.0 | −0.5 |
| Net Tax Revenue | 14.84 | 13.17 | −1.67 | 7.9 | 6.9 | −1.0 |
| Non-Tax Revenue | 2.45 | 2.46 | 0.01 | 1.3 | 1.3 | 0.0 |
| Non-Debt Capital Receipts | 0.93 | 1.03 | 0.10 | 0.5 | 0.5 | 0.0 |
| Non-Debt Receipts | 18.23 | 16.66 | −1.57 | 9.7 | 8.8 | −0.9 |
| Total Expenditure | 24.57 | 23.11 | −1.46 | 13.0 | 12.2 | −0.8 |

**Table 15 (Panel B): Declining Buoyancy of Tax Revenues**

| | Average for | | | Using 2018–19 RE as in the Budget for 2019–20 | | Using 2018–19 PE Actual Reported by CAG | |
|---|---|---|---|---|---|---|---|
| | 2010–11 to 2014–15 | 2015–16 to 2016–17 | 2017–18 | 2018–19 RE | 2019–20 BE | 2018–19 PA | 2019–20 BE |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| Gross Tax Revenue | 1.02 | 1.61 | 1.05 | 1.53 | 0.86 | 0.75 | 1.67 |
| Corporation tax | 0.82 | 0.58 | 1.58 | 1.56 | 1.29 | 1.44 | 1.40 |
| Income tax | 1.19 | 1.47 | 2.07 | 2.03 | 0.69 | 0.64 | 2.11 |
| Indirect taxes | 1.14 | 2.42 | 0.36 | 1.28 | 0.68 | 0.37 | 1.63 |

***Note:*** Tax buoyancy is defined as the ratio of the proportionate increase (over the preceding year) in tax revenue to the proportionate increase in current price GDP, and measures the responsiveness of tax revenue from a particular source to economic growth. The averages for years preceding 2017–18 are averages of annual tax buoyancy measures for those years. RE and BE refer to revised and budget estimates respectively from the Union Budget for 2019–20. PA refers to provisional actuals from the Controller General of Accounts.

***Source:*** Panel A: *Economic Survey 2018–19*, Ministry of Finance. Panel B: Calculated from tax receipts data from Union Budgets, Ministry of Finance, the Controller General of Accounts, and current price GDP data from CSO, Ministry of Statistics and Programme Implementation.

more slowly, it is lower still as the government has been able to collect a significantly smaller amount of taxes for a given rate of economic growth.

Given the actual tax revenues for 2018–19, the 2019–20 revenue estimates presented in the Union Budget (of 2019–20) seem patently unrealistic. They imply more than a doubling of the buoyancy of Gross Tax Revenues for 2019–20 – an increase from 0.75 to 1.67. Underlying this is a projected quadrupling of indirect tax buoyancy from 0.37 to 1.63. Such a bonanza in indirect tax revenues is highly improbable. A three-fold rise in the buoyancy of personal income taxes also seems implausibly high.

## 3.4 Dubious Promise of Doubling Farmers' Income in Five Years

In his Budget Speech in March 2015, the then Finance Minister spoke of the "nine distinct pillars" of the budget proposals for FY 2015–16, the first of which was described as "*Agriculture and Farmers' Welfare*: *with Focus on Doubling Farmers' Income in Five Years*". Though it was not clarified, presumably this meant a doubling of real incomes. Subsequent Budget Speeches in February 2017, 2018 and 2019 have reiterated the call to double farmers' income by 2022. It is useful to review both whether the actual progress

in agricultural incomes or the allocations for agriculture in successive budgets have been consistent with this commitment.

As noted above in Section 1, despite two good monsoons during 2016–17 and 2017–18, the average (real) agricultural growth rate over the five years from 2014–15 to 2018–19 was 2.9% per year. Even making the optimistic assumption of no growth in the population dependent on the agricultural sector (broadly consistent with a gradually declining share of agriculture in total employment and the current total population growth rate of about 1.17%), this suggests a total growth in per capita income in agriculture of just about 15% over the five-year period up to 2018–19. At this rate, real per capita income in agriculture would double its 2014–15 level only by 2038–39.[19]

Table 16 presents budgetary allocations in support of the agricultural and rural sector over the last five years. It shows allocations not only under the purview of agriculture and allied activities, but also the allocations for fertilizer subsidy as well as for rural development as the broader pool of resources for promoting agrarian and rural development. Note that the key programmes under rural development include the Mahatma Gandhi National Employment Guarantee Scheme (MGNREGS), the National Rural Livelihood Mission (NRLM), the Pradhan Mantri Awas Yojana (PMAY) and the Pradhan Mantri Gram Sadak Yojana (PMGSY); these respectively are national programmes for wage employment, self-employment, rural housing and rural road construction. Several points about the budgetary provisions for the agrarian and rural sector are notable.

First, while there has been a massive increase in the total allocation for agriculture and allied activities, from ₹37 thousand crore in FY 2015–16 to ₹152 crore for FY 2019–20, most of this increase is confined to FY 2018–19 and FY 2019–20, and is on account of the income support measure for farmers first introduced in the Interim Budget of February 2019. The growth in the budget for activities other than income support and interest subvention (the allocation for the latter has remained flat over the five years) has been far more modest, from ₹24 thousand crore in FY 2015–16 to ₹59 thousand crore for FY 2019–20. Even for FY 2019–20, allocations to agriculture net of income support and interest subvention amount to only 2% of total expenditure in the budget.

Second, the aggregate allocation for agriculture, fertilizer subsidy and rural development as a proportion of total Central Government expenditure has remained relatively flat at 11–12%; the rise to 13% for FY 2019–20 is entirely on account of the provision for direct cash support to farmers. For rural development, even the absolute nominal allocation has remained stagnant over the three-budget cycles of 2017–18, 2018–19 and 2019–20. Similarly, the fertilizer subsidy in nominal terms for 2019–20 is about the same as it was in 2015–16.

Third, for FY 2019–20, half of the total allocation for agriculture and allied activities is on account of direct income support for farmers under the PM-Kisan programme. A direct transfer of ₹6,000 per annum (per farmer) was initially announced in February 2019 Interim Budget for farmers with less than two hectares of land, but was subsequently extended to all farmers. While the need for support to the agrarian and rural economy can hardly be denied, the income support measure had the classic elements of a pre-election sop, with the government paying out the first instalment of ₹2,000 to eligible farmers within FY 2018–19 itself. To accommodate this, the then Interim Finance Minister made an allocation of ₹20 thousand crore in the revised Budget for 2018–19 itself and an additional allocation of ₹75 thousand crore for FY 2019–20. This allocation has been maintained in the July 2019 Budget. However, the merits of the direct income support measure remain questionable for a number of reasons:

(*i*) The amount of relief offered, ₹6,000 over a year, is relatively small.

(*ii*) By design, the program excludes landless workers in agriculture.

[19] An estimate by Chand (2017) suggests that real income per cultivator grew at the rate of 3.4% per annum between 1993–94 and 2015–16. At this higher rate too, it would take about 21 years for the average income per cultivator to double.

**Table 16: Budgetary Allocations for Agriculture and the Rural Sector**

| | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019–20 Budget Estimates |
|---|---|---|---|---|---|
| | (₹'000 crore) | | | | |
| Total Agriculture and Allied Activities | 36.7 | 50.2 | 52.6 | 86.6 | 151.5 |
| *Activities other than interest subvention and income support* | 23.7 | 36.8 | 39.6 | 51.6 | 58.5 |
| *Interest subvention* | 13.0 | 13.4 | 13.0 | 15.0 | 18.0 |
| *Income support scheme* | | | | 20.0 | 75.0 |
| Fertilizer Subsidy | 72.4 | 66.3 | 66.4 | 70.1 | 75.0 |
| Rural Development | 90.2 | 113.9 | 135.0 | 135.1 | 139.0 |
| **Total** | **199.3** | **230.4** | **254.0** | **291.8** | **365.5** |
| | (% of total budget expenditure) | | | | |
| Total Agriculture and Allied Activities | 2.0 | 2.5 | 2.5 | 3.5 | 5.4 |
| *Activities other than interest subvention and income support* | 1.3 | 1.9 | 1.8 | 2.1 | 2.1 |
| *Interest subvention* | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 |
| *Income support scheme* | 0.0 | 0.0 | 0.0 | 0.8 | 2.7 |
| Fertilizer Subsidy | 4.0 | 3.4 | 3.1 | 2.9 | 2.7 |
| Rural Development | 5.0 | 5.8 | 6.3 | 5.5 | 5.0 |
| **Total** | **11.1** | **11.7** | **11.9** | **11.9** | **13.1** |

***Source:*** Union Budget Documents (Various Years), Ministry of Finance.

(*iii*) It may also exclude many women farmers given the state of land registration in India.

(*iv*) The eligibility of cultivators under various tenancy arrangements also remains unclear.

(*v*) Short-term income relief is no substitute for longer-term investments in agriculture.

Fourth, there are also significant concerns regarding the ultimate benefits of fertilizer subsidy. This subsidy is offered to fertilizer companies and importers on a cost-plus basis with a regulated maximum retail price (MRP), which creates the perverse incentive of higher subsidies to more inefficient firms. In the case of Urea, which accounts for 70% of the total fertilizer subsidy, the analysis undertaken in the *Economic Survey 2015–16* highlighted serious leakages through (*i*) a thriving black market with 51% of farmers buying Urea above the MRP with an average mark-up of 60%, and (*ii*) support to inefficient fertilizer producers with an estimated efficiency cost equivalent to about a quarter of the Urea subsidies (MoF, 2016b). This is over and above the social cost of subsidies in distorting the optimal use of fertilizers.

Fifth, the Budgets for FY 2018–19 and FY 2019–20 also announced the extension of the minimum support price (MSP) system to 22 crops on at least a 50% cost-plus basis. The minimum 50% mark-up on production costs was ostensibly based on the recommendation of the National Commission on Farmers (2006) headed by Prof. M.S. Swaminathan. However, government has used a narrower concept of production costs, the so-called A2 + FL cost, rather than the full C2 costs (as implied in the Swaminathan Commission recommendations).[20] The MSP for wheat has already been well above 50% mark-up on the A2 + FL costs for more than a decade, and the MSP for paddy has been close to, and in some years higher than, 50% mark-up on A2 +FL costs (Himanshu, 2018). Thus, it is unclear how much additional support these MSP measures offer to the farmers.

[20] The difference between the two cost concepts is that the C2 cost, over and above the production costs included in the A2+FL cost, also includes interest on the value of owned capital assets, the rental value of owned land (net of land revenue) and rent paid on leased-in land.

Moreover, the entire MSP system itself is in need of a serious review. The current price support system is often ineffective as it fails to set a floor to market prices because of limited procurement, especially when and where it is most needed. It is also costly and distortionary because of inefficient procurement and storage, the corruption the system induces, and the high social cost of incentivizing wrong crops in wrong places.

In sum, despite the promise of doubling framers' incomes in five years, the recent budgets have lacked a vision for promoting higher productivity and growth in the agricultural sector. The budgets have missed opportunities for serious policy reform. For instance, the introduction of the PM-Kisan direct transfer programme missed the opportunity to subsume a number of distortionary agricultural subsidies under it, even if that may have implied a larger direct transfer. Budgetary allocations have also failed to prioritize greater resources for investment and R&D in agriculture. For instance, there is a mere ₹8 thousand crore FY 2019–20 allocation for agricultural R&D, and this allocation has not increased much since 2015–16. As noted by Gulati (2019), "[This] is literally for the whole country and for all crops… In contrast, just one global company, Bayer, had spent $2.3 billion (about ₹16,000 crore) on agri-R&D in 2018. If India's public agri-R&D outlays cannot even compete with one global company's expenditure on agri-R&D, how can we even dream of making our farmers globally competitive and increase our agricultural exports as envisioned by the finance minister in her 10–point agenda?"

## 3.5 Continued Underspending on Health and Education

The under-provision of health care and education has been an endemic issue for development policy in India. The Union Budgets of the last five years have failed to break any new ground in this respect. The combined spending for education, health, drinking water and sanitation has on average been about 6.6% of the Central Government expenditure during FY 2015–16 through FY 2019–20 with little change from year to year (Table 17). If anything, the share of education has been gradually declining over time. To put this in perspective, defence spending alone accounts for about 17% of the Union Budget, more than 2.5 times the combined spending on education, health, drinking water and sanitation.

As a proportion of GDP, total Central Government spending on education, health, drinking water and sanitation averages less than 0.9% over the five budget cycles from FY 2015–16 to FY 2019–20, and this too has been gradually declining over the years (Table 17). Of course, within the federal system, the States in India have a major responsibility in education and health sectors. However, even the combined Centre and States spending on education and health has been stagnating at about 4% of GDP for a long time (Table 17), and is very low by international standards (the world average for 2014 was about 11% of GDP, about 5% for education and 6% for health[21]).

In the case of education, this is happening against the backdrop of rapidly growing demand, which is reflected in increasing enrolment rates at all levels, though net enrolment rates at upper secondary and higher levels of education still remain low by international standards. Even more important is the quality of both school and higher education, which remains a major challenge with serious implications for employability. While education is the joint responsibility of the Central and State Governments, centre's share in education spending has been declining and Union Budgets have missed the opportunity to do more in this space including through tying Central Government funding to performance-based outcomes in states.

In relation to health, the 2018–19 Budget announced "a flagship National Health Protection Scheme to cover over 10 crore poor and vulnerable families (approximately 50 crore beneficiaries) providing coverage up to ₹5 lakh per family per year for secondary and tertiary care hospitalization. This will be the world's largest government funded health care programme" (Budget Speech of the Finance Minister, Union Budget 2018–19, Ministry of Finance.) However, the 2018–19 Budget only made a meagre allocation of ₹2,000 crore to the National Health Insurance Programme Rashtriya Swasthya Bima Yojna (RSBY) for FY 2018–19. The revised estimate for RSBY for FY 2018–19 was ₹2,700 crore, and the allocation in the Budget for FY 2019–20 is ₹6,556 crore. It

[21] World Bank (2018). *World Development Indicators*, World Bank (http://data.worldbank.org).

**Table 17: Spending on Education, Health, Drinking Water and Sanitation by Union and State Governments**

| | 2012–13 Actuals | 2013–14 Actuals | 2014–15 Actuals | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019–20 Budget Estimates | Average 2015–16 to 2019–20 |
|---|---|---|---|---|---|---|---|---|---|
| ***Union Government*** | **(% of total expenditure)** | | | | | | | | |
| Education | 4.7 | 4.6 | 4.1 | 3.8 | 3.6 | 3.7 | 3.4 | 3.4 | 3.6 |
| Health | 1.9 | 1.9 | 1.9 | 1.9 | 2.0 | 2.5 | 2.3 | 2.3 | 2.2 |
| Drinking water and sanitation | 0.9 | 0.8 | 0.7 | 0.6 | 0.8 | 1.1 | 0.8 | 0.7 | 0.8 |
| **Total** | **7.5** | **7.2** | **6.8** | **6.3** | **6.5** | **7.3** | **6.5** | **6.5** | **6.6** |
| ***Union Government*** | **(% of GDP)** | | | | | | | | |
| Education | 0.66 | 0.63 | 0.55 | 0.49 | 0.47 | 0.48 | 0.44 | 0.45 | 0.47 |
| Health | 0.27 | 0.26 | 0.25 | 0.25 | 0.26 | 0.32 | 0.30 | 0.31 | 0.29 |
| Drinking water and sanitation | 0.13 | 0.11 | 0.10 | 0.08 | 0.11 | 0.14 | 0.11 | 0.10 | 0.11 |
| **Total** | **1.07** | **1.00** | **0.90** | **0.82** | **0.84** | **0.94** | **0.85** | **0.86** | **0.86** |
| ***Union and State Governments*** | **(% of GDP)** | | | | | | | | |
| Education | 3.1 | 3.1 | 2.8 | 2.8 | 2.8 | 2.9 | 3.0 | | |
| Health (including drinking water and sanitation) | 1.3 | 1.2 | 1.2 | 1.3 | 1.4 | 1.5 | 1.5 | | |
| **Total** | **4.4** | **4.3** | **4.0** | **4.1** | **4.2** | **4.4** | **4.5** | | |

***Source:*** *Economic Survey 2017–18* and *2018–19*, Volume II, Ministry of Finance; Union Budgets (Various Years), Ministry of Finance; CGBA (2018, 2019).

is obvious that there is no clear financing plan for the ambitious scheme, which largely remains an unfunded mandate.

Similarly, the Interim Budget for FY 2019–20 announced the setting up of 21 AIIMS-type facilities throughout the country. However, only six of these are in operation, while fifteen have been announced since 2014: four in the Budget Speech of 2014–15, seven during 2015–16, three in 2017–18 and one in the Interim Budget Speech of 2019–20. The average cost of the more recently announced facilities is upwards of ₹,1200 crore each. In contrast, the capital expenditure budget of the Pradhan Mantri Swasthya Suraksha Yojana (PMSSY), which includes the setting up of AIIMS facilities in addition to upgradation of Government Medical Colleges, has been falling from ₹2,234 crore in FY 2017–18, to ₹1,975 crore in FY 2018–19 (RE) to an allocation of ₹1139 crore for FY 2019–20. In light of these allocations, there are some serious question marks on when these facilities will actually be operational.

A big initiative of the NDA government has been the *Swachh Bharat Mission* (SBM) launched on October 2, 2014 with the goal of making India Open Defecation Free (ODF) by October 2019. The main plank of SBM has been the construction of toilets. Official statistics by the Ministry of Drinking Water and Sanitation claim that as of January 2019, 92.2 million toilets had been built since the inception of SBM, leading to a 98% rural sanitation coverage with 604 districts and 5,52,000 villages declared ODF. As against this, Table 18 presents recent evidence on the progress of sanitation from two rounds of the National Sample Survey Organization's *Swachh Bharat Survey*.

These data indicate substantial progress between mid-2015 and the end of 2017, especially in rural areas, with the percentage of rural households with sanitary toilets rising from 45% to 64%. However, these data also indicate an open defecation rate of 33% in rural India for July-December 2017, which is substantially more sobering than the official claim of 98% rural sanitation coverage. While noting the progress made, there is clearly a lot more to be done to realize the goal of on open defecation free India.

## 3.6 Fluctuating Spending on Safety Nets

Four of India's major social safety nets relate to:

(*i*) The provision of subsidized food through the Public Distribution System (PDS).

(*ii*) The provision of low-wage employment to unskilled labour in rural areas under the Mahatama Gandhi National Rural Employment Guarantee Scheme (MNREGS).

**Table 18: Progress in Sanitation**

| | May–June 2015 | | July–December 2017 | |
|---|---|---|---|---|
| | Rural | Urban | Rural | Urban |
| % of households having sanitary toilet | 45 | 89 | 64 | 94 |
| % of households having water for use in the toilet | 43 | 88 | 62 | 93 |
| % of persons not using any type of toilet (open defecation) | 52 | 8 | 33 | 4 |

***Source:*** NSSO (2018).

(*iii*) Supplementary nutrition, healthcare and education for pre-school children and their mothers under the Integrated Child Development Services (ICDS) Programme, and

(*iv*) The Mid-day Meal Programme for primary (Class I to Class V) and upper-primary (Class VI to Class VIII) school-going children.

The importance of these programmes in improving the wellbeing of the poor has been documented in a number of studies (see for instance, discussion in Dreze and Sen, 2013, and Dreze, 2017). The combined spending on these programmes has represented about 10% of the budget in recent years, which is not very different to their share in FY 2014–15 (Table 19).

However, spending on these programmes has been fluctuating, and not all fluctuations are demand-driven. For instance, PDS spending sharply declined in 2016–17 and 2017–18 followed by growth later (Table 19). Spending on ICDS too fell in 2015–16 and 2016–17 before recovering in later years. For MNREGS, the rise in spending during FY 2016–17 reflects in part the spike in MNREGS employment in the months following the demonetization of November 2016 and its negative impact on people's livelihood, especially those in the informal sector. There has been a gradual growth in expenditure allocations for MNREGS since then, though there has been a cut in the allocation for FY 2019–20. The overall increase in MNREGS allocations since 2014–15 however in any case needs to be viewed against the evidence of significant unmet demand for MNREGS work even in "normal" years. For instance, Dutta, et al. (2012) estimated that 44% of households who wanted MNREGS work failed to get MNREGS work in 2009–10.

## 3.7 Low-Tax Low-Spend Fiscal Equilibrium with a Relatively Low Share of Direct Taxes

Finally, we circle back to a longstanding issue with fiscal policy in India—that it seems to be stuck in a low-tax low-spend equilibrium. Notwithstanding the concerns with fiscal consolidation and slippage, it is worth noting the simple point that the same level of fiscal deficit can be achieved with higher (or lower) levels of both receipts and expenditures. The Nobel Laureate, Joseph Stiglitz, writing in the context of "deficit fetishism" in the US observed that "If the government simultaneously increases taxes and increases expenditures—so that the current deficit remains unchanged—the economy can be stimulated". (Stiglitz, 2012.)

The argument is also relevant to fiscal policy in India. The basic fiscal arithmetic of the five recent budgets seems simple. It appears that the Union Budgets have taken four parameters as more or less given:

(*i*) Gross tax revenue of about 11% of GDP.

(*ii*) A net tax revenue of about 7% of GDP after netting out the states' share as mandated by the Finance Commissions.

(*iii*) Other non-tax receipts (including non-debt capital receipts) of about 2% of GDP, and

(*iv*) A target fiscal deficit of about 3.5% of GDP on average.

These four parameters pretty much fix an expenditure-to-GDP ratio of around 12.5% as the union government's overall spending envelope (Table 20). There has been some decline in the fiscal deficit during 2015–16 and 2016–17 with a parallel decline in the expenditure-GDP ratio, but the basic fiscal math has largely remained unchanged.

Even this fiscal math has come under stress since 2018–19 due to the aforementioned shortfall in revenue receipts of the Central Government as revealed by the CGA's provisional actual numbers for that year. This is shown in the last column of Table 20. Gross tax revenues dropped to 10.4% of GDP and total non-debt receipts of the union government fell to 8.3% of GDP. As the government sought to contain the fiscal deficit, this led to a further expenditure compression to about

**Table 19: Spending on Major Safety Net Programmes**

| | 2014–15 Actuals | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019–20 Budget Estimates | Average 2015–16 to 2019–20 |
|---|---|---|---|---|---|---|---|
| | (₹'000 crore) | | | | | | |
| Public Distribution System (PDS) | 117.7 | 139.4 | 110.2 | 100.3 | 171.3 | 184.2 | 141.1 |
| MGNREGS | 33.0 | 37.3 | 48.2 | 55.2 | 61.1 | 60.0 | 52.4 |
| Core ICDS | 16.7 | 15.5 | 14.6 | 16.0 | 21.0 | 23.2 | 18.1 |
| Mid-day Meals (MDM) | 10.5 | 9.1 | 9.5 | 9.1 | 9.9 | 11.0 | 9.7 |
| **Total** | **177.9** | **201.4** | **182.5** | **180.6** | **263.3** | **278.5** | **221.2** |
| | (% of GDP) | | | | | | |
| Public Distribution System (PDS) | 0.94 | 1.02 | 0.72 | 0.60 | 0.91 | 0.88 | 0.82 |
| MGNREGS | 0.26 | 0.27 | 0.32 | 0.33 | 0.32 | 0.29 | 0.31 |
| Core ICDS | 0.13 | 0.11 | 0.10 | 0.10 | 0.11 | 0.11 | 0.11 |
| Mid-day Meals (MDM) | 0.08 | 0.07 | 0.06 | 0.05 | 0.05 | 0.05 | 0.06 |
| **Total** | **1.42** | **1.47** | **1.20** | **1.08** | **1.40** | **1.33** | **1.29** |
| | (% of total expenditure) | | | | | | |
| Public Distribution System (PDS) | 7.1 | 7.8 | 5.6 | 4.7 | 7.0 | 6.6 | 6.3 |
| MGNREGS | 2.0 | 2.1 | 2.4 | 2.6 | 2.5 | 2.2 | 2.3 |
| Core ICDS | 1.0 | 0.9 | 0.7 | 0.7 | 0.9 | 0.8 | 0.8 |
| Mid-day Meals (MDM) | 0.6 | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 0.4 |
| **Total** | **10.7** | **11.2** | **9.2** | **8.4** | **10.7** | **10.0** | **9.9** |

***Source:*** Union Budget (Various Years), Ministry of Finance.

11.7% of GDP. The expenditure cuts have come at a time when the economy has been rapidly slowing down as discussed above.

There however remains the larger question regarding the basic fiscal math underlying the recent budgets, in particular, whether Indian budgets tend to both under-tax and under-spend.[22] It is arguable that a Central Government expenditure ratio of about 12.5% of GDP, or even a consolidated Central and State Government expenditure ratio of about twice as much is low for a democratic country at India's current stage of development.[23]

But supporting a higher level of public spending will require greater effort on revenue mobilization, especially with respect to direct taxes, which have been stagnating at less than 7% of GDP for nearly a decade, resulting in a continued heavy reliance on indirect taxes which contribute about 63% of total tax revenue of the Centre and the States (Figure 9). The share of direct taxes in the gross tax revenues of the union government has in fact been declining, from around 57% during 2010–11 to 2014–15 to about 51% during 2015–16 to 2018–19 (Figure 9). The collection of direct taxes by the state governments is far more limited. Thus, the share of direct taxes in total tax revenues of the Central and State Governments is much lower, and also declining; it has been only around 36–37% in recent years.

Thus, the evidence points to very limited reach of the direct tax system in India. Despite rapid economic growth over this period, combined direct tax receipts of the Centre and the States have averaged around 6.5% of GDP (Figure 9). The reach of both personal and corporate income taxes is limited. According to the data released by the Income Tax Department, the total number of individual income tax assessees (those who filed income tax returns plus cases of tax deduction at source) was 70.3 million during AY 2017–18 (Table 21).[24] The data also show that 43% of the tax returns had a zero taxable income. The total number of individual taxpaying assessees (including Hindu undivided families[25]) was only about 40.4 million. As against this, projections of the workforce based on NSS data from the last two rounds of its employment surveys for 2011–12 and 2017–18 indicate that India had about 467 million usual (principal and secondary) status workers in AY 2017–18. In other words, only 8.6% of workers in India were taxpayers.

[22] In the Indian context, see Shetty (2016), for instance, for making such an argument.

[23] Cross-country analysis presented in the *Economic Survey* of 2015–16 and 2017–18 lends credence to such a view (MoF, 2016b, 2018).

[24] The assessment year (AY) is the year following the financial year and refers to the year in which incomes are assessed.

[25] Hindu Undivided Families are treated as a 'persons' under the Income Tax Act, 1961

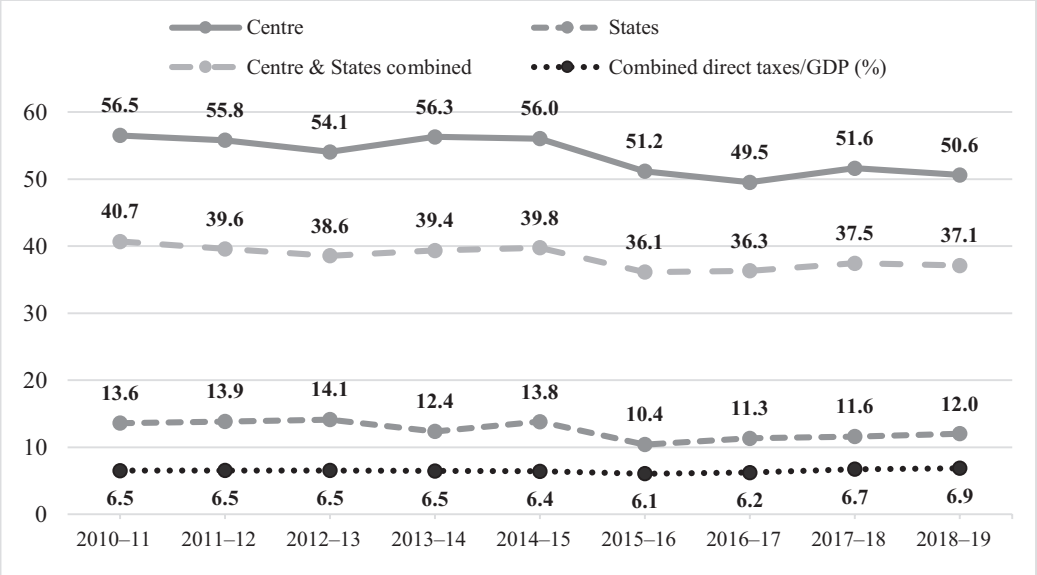


**FIGURE 9: Share of Direct Taxes in Total Taxes of the Centre and States and the Overall Direct Tax/GDP Ratio (%)**.

***Source:*** Reserve Bank of India, *Database of the Indian Economy*.

**TABLE 20: Basic Fiscal Arithmetic of the Last Five Budgets**

| | 2015–16 Actuals | 2016–17 Actuals | 2017–18 Actuals | 2018–19 Revised Estimates | 2019–20 Budget Estimates | Average 2015–16 to 2019–20 | 2018–19 Provisional Actuals |
|---|---|---|---|---|---|---|---|
| | (₹ trillion) | | | | | | |
| Gross Tax Revenue* | 14.6 | 17.2 | 18.6 | 21.6 | 23.5 | 19.1 | 19.8 |
| Net Tax Revenue (Net of States' Share)* | 9.4 | 11.0 | 11.8 | 13.9 | 15.4 | 12.3 | 12.2 |
| Non-tax Receipts (including Non-debt Capital Receipts) | 3.1 | 3.4 | 3.1 | 3.4 | 4.3 | 3.5 | 3.5 |
| Total Non-debt Receipts of Central Government* | 12.6 | 14.4 | 14.9 | 17.3 | 19.7 | 15.8 | 15.7 |
| Fiscal Deficit | 5.3 | 5.4 | 5.9 | 6.3 | 7.0 | 6.0 | 6.5 |
| Total Expenditure of Central Government* | 17.9 | 19.8 | 20.8 | 23.7 | 26.8 | 21.8 | 22.2 |
| | (% of GDP) | | | | | | |
| Gross Tax Revenue* | 10.6 | 11.2 | 10.9 | 11.4 | 11.1 | 11.1 | 10.4 |
| Net Tax Revenue (Net of States' Share)* | 6.9 | 7.2 | 6.9 | 7.3 | 7.3 | 7.2 | 6.4 |
| Non-tax Receipts (including Non-debt Capital Receipts) | 2.3 | 2.2 | 1.8 | 1.8 | 2.1 | 2.0 | 1.8 |
| Total Non-debt Receipts of Central Government* | 9.2 | 9.4 | 8.7 | 9.1 | 9.4 | 9.2 | 8.3 |
| Fiscal Deficit | 3.9 | 3.5 | 3.5 | 3.3 | 3.3 | 3.5 | 3.4 |
| Total Expenditure of Central Government* | 13.1 | 12.9 | 12.2 | 12.5 | 12.7 | 12.6 | 11.7 |

***Note:*** * Net of GST Compensation Cess.

***Source:*** Union Budget (Various Years), Ministry of Finance.

Similarly, in relation to corporate taxes, of the 2.16 million companies and firms filing tax returns in AY 2017–18, 49% of the companies and 24% of firms filed zero-tax returns. Thus, only 1.43 million companies and firms were taxpaying entities for the country as a whole. This number has seen very modest growth in recent years (Table 21). The evidence also points to problems of tax avoidance and tax compliance. For instance, the effective tax rate for companies has typically been well below the statutory rate, reflecting a number of exemptions in the tax code and various forms of tax avoidance.[26] In addition, India has no wealth or inheritance tax. The union government

[26] In 2017–18, the effective tax rate amongst the companies assessed was 28.24% as against the statutory rate of 34.47%, where the statutory tax rate is calculated as a weighted average of the tax rate of 33.06% in the case of companies having total income up to ₹10 crore and 34.6% in the case of companies having total income exceeding ₹10 crore (*Union Budget 2017–18*, Ministry of Finance).

**Table 21: Personal and Corporate Income Tax Assessees, AY 2014–15 to AY 2017–18**

| | AY 2014–15 | AY 2015–16 | AY 2016–17 | AY 2017–18 |
|---|---|---|---|---|
| **Personal Income Taxes** | | | | |
| *Individuals* | | | | |
| Tax assessees (million) | 53.91 | 58.09 | 65.60 | 70.32 |
| % of zero-tax returns | 47.7 | 49.5 | 44.4 | 43.4 |
| Taxpaying assessees (million) | 28.20 | 29.34 | 36.46 | 39.81 |
| *Hindu undivided families* | | | | |
| Tax assessees (million) | 1.00 | 1.06 | 1.12 | 1.14 |
| % of zero-tax returns | 52.0 | 55.6 | 51.5 | 49.1 |
| Taxpaying assessees (million) | 0.48 | 0.47 | 0.54 | 0.58 |
| **Total taxpaying assessees (million)** | **28.68** | **29.81** | **37.00** | **40.39** |
| Estimated usual (ps + ss) status workers (million) | 475.78 | 472.99 | 470.21 | 467.45 |
| **Personal income taxpayers as % of workers** | **6.0** | **6.3** | **7.9** | **8.6** |
| **Corporate Taxes** | | | | |
| *Companies* | | | | |
| Tax assessees (million) | 0.75 | 0.77 | 0.81 | 0.84 |
| % of zero-tax returns | 52.3 | 47.8 | 48.9 | 48.7 |
| Taxpaying assessees (million) | 0.36 | 0.40 | 0.41 | 0.43 |
| *Firms* | | | | |
| Tax assessees (million) | 1.09 | 1.16 | 1.25 | 1.32 |
| % of zero-tax returns | 25.0 | 25.6 | 26.1 | 24.2 |
| Taxpaying assessees (million) | 0.82 | 0.86 | 0.93 | 1.00 |
| **Total taxpaying assessees (million)** | **1.18** | **1.27** | **1.34** | **1.43** |

***Note*: *** Effective assessees include those filing tax returns plus those with income tax deductions at source.
ps: primary status; ss: secondary status.
***Source*:** Income Tax Department (2017, 2018a, b, c, d), NSSO (2013, 2019).

dispensed with the wealth tax in April 2016. The inheritance tax was abolished in 1985.

The problem extends even beyond Central and State Governments. Recent analysis presented in the *Economic Survey 2017–18* also indicates a very weak effort at collection of direct taxes at lower levels of government, and this does not appear to be simply a matter of inadequate devolution of taxation powers (MoF, 2018). The evidence instead points to a gross under-utilization of the powers available to the lower tiers of government for the collection of direct taxes, especially taxes on property. Thus, the overall low tax effort, especially in relation to direct taxes, afflicts all tiers of government, and remains a serious and binding constraint on fiscal policy in India.

## 4. CONCLUSION OF UNION BUDGET FROM 2015-16 TO 2019-20

In 2014, the NDA had swept into power with an unprecedented political mandate. If that was unprecedented, in May 2019, the NDA returned with an even bigger majority in the Lok Sabha. With the ruling party and its allies also controlling the majority of the state legislatures, the political environment offered more degrees of freedom for fiscal reform than had been available to any government over the past three decades. In one important area, this opportunity was capitalized, namely, the introduction of the GST in 2017, which represented a major reform of the indirect tax system. Though even in the case of the GST, the groundwork of the previous thirteen years leading up to GST Act ought to be acknowledged, and the GST "success" also needs to be qualified by some of the persisting consequences of shortcomings in its design and implementation. Nonetheless, this is one area where the political degrees of freedom were successfully cashed in.

However, with this notable exception, one could argue that the grand political opportunity for fiscal reform was largely missed by the Union Budgets of the last five years. In most respects, the budgets have followed a more or less set course with relatively minor tinkering from year to year. There has been a measure of achievement in terms of fiscal consolidation, continuing a process that started a couple of years before the

NDA-I government assumed office. But gains in fiscal consolidation were confined to the first two budgets of the NDA-I government and were mostly enabled by the windfall gains of low global crude oil prices. Fiscal consolidation has stalled since, and if one were to take into account various forms of off-budget financing, the effective fiscal deficit of the union government is likely to be closer to 6 % than the officially claimed figure of 3.3–3.5%.

Apart from off-budget financing, the finances of the union government are coming under additional stress due to revenue shortfalls. The audited accounts of the government indicate a significant revenue shortfall for FY 2018–19 of the order of nearly 1% of GDP mainly due to shortfalls in GST and income tax collections. Yet, the response of the government has taken the form of expenditure cuts in a bid to maintain the fiscal deficit at around 3.4%. Together with the experience of previous years, it is evident that the fiscal consolidation of recent years has not been revenue-led but one achieved through expenditure compression.

As a consequence, there has been some shrinkage in the size of the budget (relative to GDP) while there has been little change in its composition. Thus, many of the structural limitations of the budget in supporting greater development spending have continued. Public spending on social sectors (education and health) and safety nets as well as public investment a proportion of GDP have been stagnant at best. There has also been limited movement on the resource mobilization front. There is little evidence yet that the GST has helped significantly expand revenues from indirect taxation, while direct tax collections continue to be constrained by a narrow tax base. Union Budgets have thus remained stuck in a low-tax low-spend equilibrium, which has ultimately also constrained the redistributive role of fiscal policy. Several of these limitations go beyond the Union Budgets and afflict the budgets of state and lower tier governments as well. However, the Union Budgets of the last five years have missed the opportunity to play a catalytic role in this regard and decisively address pressing challenges on several fronts including education, health, employment and the agrarian economy.

Meanwhile, the economic landscape has changed considerably since 2017–18. Not only have the windfall gains of falling crude oil prices evaporated, the economy is in the throes of a serious slowdown with a near-collapse of manufacturing growth, slump in private consumption and investment, rising levels of unemployment and declining labour force participation. This shifting landscape has called into question the merits of a continued pursuit of fiscal consolidation, especially when the macroeconomic risks of fiscal deficits are relatively low. Yet, right up to the recent budget of July 2019, the government has stuck to the mantra of fiscal consolidation projecting a fiscal deficit of 3.3% of GDP for FY 2019–20.

There are however indications that the economic and fiscal realities are finally catching up with the union government. The response has come in the form of recent post-budget announcements, two of which are noteworthy. First, the government has sought to bolster its non-tax revenues by securing (on August 26, 2019) the largest possible transfer of dividend and "surplus" capital from the RBI (of ₹1.76 trillion) with the RBI's Central Board opting for the minimum realized equity of the central bank consistent with the recommendation of an Expert Committee. This will help cover the hole in current tax revenues, but it is no more than a one-time fix to the more enduring problem of resource mobilization.

Second, the government has finally shown some willingness to address the economic slowdown and relax the fiscal deficit target. However, the fiscal stimulus has taken the form of corporate tax cuts, with government announcing (on September 20, 2019) a slashing of the effective corporate tax rate (including surcharges and cess) from about 35% to 25% and a lower 15% corporate tax for new manufacturing firms. The move leaves more profits in corporate hands and not surprisingly has been welcomed by the corporate sector and equity markets. The government is betting that it will dispel the current gloom in the business community, revive private investment and make India an attractive destination for foreign investors. While there is a case for aligning corporate taxation in India with current rates internationally, it remains doubtful how far the move can boost private investment in a situation of depressed demand. The price tag for these tax concessions is ₹1.45 trillion in revenue foregone, which will push the fiscal deficit for FY 2019–20 from the projected 3.3% to 4% of GDP. The issue is not the higher fiscal deficit per se, as some form of fiscal expansion seemed warranted by the current economic situation. The concern is that corporate tax cuts are more likely to influence the distribution of income than stimulate demand. Other forms of fiscal stimulus through appropriate expansion of public spending and investments could arguably have done more for both stimulating demand and improving income distribution.

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