India is undergoing a growth slowdown currently, but various macro indicators over the last few years show there has been a marked improvement. The debt and deficit situation of India seems better than many advanced and emerging economies. Importantly, India has undergone structural changes including demonetization (Nov’16) and GST (Jul’17 and is still stabilizing). Post these developments, there has been a visible increase in the number of tax payers. In FY18, total number of tax payers increased to 7.41 crore from 6.92 crore in FY17 and 6.15 crore in FY16. Number of persons filing returns also increased to 5.43 crore in FY18 compared to 4.47 crore and 3.90 crore respectively in the previous two years. However, the number of e-filings which rose significantly between FY16-FY18 declined marginally in FY19 by around 6.6 lakh. Against this backdrop, Indian policy makers have taken a fiscal consolidation path to reach a target of 3% in FY21 as suggested by the FRBM committee. In FY19 the Government has been able to meet the revised fiscal deficit estimate of 3.4% of GDP. However, there has been Rs 1.45 lakh crore reduction in expenditure exactly matching Rs 1.57 lakh crore reduction in total receipts. Now that FY19 estimates are revised, FY20 estimates might seem to be on the higher side. On the global front, world trade tensions have been intensifying this past year, with President Trump announcing protectionist measures one after the other. This has led to extreme volatility in the markets as global growth prospects are threatened owing to slowing trade. Crude oil prices have also been sliding since US announced that it will impose tariffs on China and then Mexico. Within a span of 6 days crude declined from $70/bbl to $61/bbl (likely to go below $60). In India’s case, the outcome is mixed with falling crude helping 10 yr yield (below 7%) and CAD on the one hand, while slowing world exports dragging down India’s exports. With more than 10% of India’s exports to USA getting impacted due to termination of GSP, increased US belligerence to its trade deficit with India and worsening global conditions, the Government will have to very diplomatically manoeuvre the external relations to support the economy. Also, the question arises whether the Government should continue to focus on fiscal consolidation path or say keep the deficit numbers constant for the next two years before reducing it further and try to revive growth. The Government should strive to make credible, transparent fiscal rules that are achievable. We believe that the Government should target structural deficit as an alternative to targeting fiscal deficit. Such structural deficit acts as an automatic counter-cyclical stabilizer unlike the current target that has been set from the outset as a fixed percentage of GDP and is a statistical artefact! With India getting a woman FM for first time in 72 years, its time for new thinking!

**PRIORITIES FOR THE NEW GOVERNMENT**

- India’s macro economic stability parameters, viz. growth, inflation, fiscal deficit and external balance have shown remarkable improvement over the years. Average CPI inflation which was 9.5% in Mar’13 has come down to 3.9% in FY19. Growth which had slowed down after demonetization and GST implementation has bounced back to 7% levels, but is now down to below 6% (Q4 FY19).

- Meanwhile, exchange rate and 10-year yield volatility which increased after demonetization stabilized thereafter again peaked in Q3 2018 amidst the US Fed rate hike. In 2019, financial volatility increased again but it remained at lower levels compared to 2018. Election related uncertainty and persisting US-China trade conflict continued to affect the markets globally. With landslide victory of Modi led NDA Government the sentiments has now got a boost, suggesting decline in financial volatility going forward.

- To boost economic growth, India needs a clear focus on the rural sector. Clear and tangible efforts are needed on designing a suitable price incentive for farmers. Consolidation in banking sector, adding more infrastructure to NCLT process through judicial reforms, export promotion, boost to investment and manufacturing, focus on skilling to improve employability of Indian youth are certain other areas that require attention.

**REDEFINING FISCAL PRUDENCE**

- India’s Gross fiscal deficit as % of GDP has declined to 3.4% in FY19. However, to achieve revised target in FY19 there has been a drastic reduction of Rs 1.45 lakh crore in expenditure with Rs 69,140 crore cut in subsidies (major cut in food subsidy of Rs 69,394 crore), covering for Rs 1.57 lakh crore reduction in total receipts.
Now that FY19 estimates are revised, the FY20 fiscal estimates might seem to be on the higher side, specially for tax revenue and revenue expenditure. For BE FY20, annual growth rate of tax revenue now comes to 29.5% (much higher than the decadal growth of 12.5%) while, revenue expenditure growth is at 21.9% compared to decadal growth of 9.2%. Thus it seems these estimates are likely to be revised in the upcoming full budget on 5 Jul’19. For FY20, fiscal deficit target is again set at 3.4% of GDP.

Meanwhile, as against the advanced countries where Government Debt has continued to increase despite austerity measures, Indian Central Government Debt has progressively declined over the years from 50.5% of GDP in 2008 to 45.6% of GDP in 2018.

India is on the fiscal consolidation path to reach 3% target set for FY21 by the FRBM committee. However, although fiscal prudence is a necessary condition for maintaining macro stability, it is not sufficient. Moreover, the 3% target has its basis in the Maastricht Treaty of 1992. Given the increased growth concerns that the country is facing, and given that India has embarked on a new indirect tax regime and slowdown in direct taxes we believe the Government should not pursue the path of “fiscal austerity”.

**NON-TAX REVENUE GENERATION BY GOVERNMENT**

Another important issue that needs to be looked at is the use of non-tax revenues for meeting fiscal deficit by the Government. Using the data from FY1972 to FY2017, our estimates show that neither non-tax revenue growth causes GDP growth, nor the GDP growth causes non-tax revenue growth.

Thus, the Government should not overtly rely on non-tax revenue unless growth picks up. In fact, higher non-tax revenue growth can cause sectoral imbalance. The case in point is the telecom sector, which witnessed an increase in leverage in 2010 when major spectrum auction happened. Leverage which stabilized in FY17, increased in the past years. For FY19, leverage ratio has increased largely due to erosion in net worth.

**STRUCTURAL FISCAL BALANCE**

The alternative to targeting fiscal deficit is that like most advanced economies and several emerging market economies India should target a structural deficit, which serves as an automatic counter-cyclical stabiliser.

As non-tax revenue and GDP do not have causal relationship, non tax revenues (including telecom auction) and even disinvestments receipts should be excluded while calculating Government balance. India witnessed major telecom auction in 2010, if we exclude its revenue and also the disinvestment receipts FY11 structural fiscal deficit increases to 6.1% from 4.8%.

Even IMF comes up with the structural fiscal balance for every country which is an extension of the cyclically adjusted balance that also corrects for other non-recurrent effects that go beyond the cycle, such as one-off operations and other factors whose cyclical fluctuations do not coincide with the output cycle (for instance, asset and commodity prices and output composition effects). Based on this, projected balance for India comes to an average of -6.3% for 2018-23 period, as per IMF.
Clearly, it looks even the IMF finds it difficult for consolidated deficit to decline meaningfully below 6% in the next couple of years. The question is therefore, do we keep it at current level of 6-6.5%, or go down the FRBM glide path to 5%?

The FRBM committee report has stated that for Emerging Market Economies including India it is difficult to arrive at structural balance as they are on the path of structural transformation and in lieu of that escape clause has been built in which allows deviations from fiscal rules in the case of exogenous shocks outside the policymaker’s control.

A recent RBI paper on emerging market economies using the structural balance approach found out that in the post-crisis years (2008-10), the impact of fiscal stimulus turned out to be positive and statistically significant. The study concludes that the observed slump in growth in the post-crisis period would have been much sharper in the absence of stimulus, implying that fiscal activism pursued by these EMEs was successful in arresting the downslide of growth.

Given growth slowdown that India is facing, the question arises whether the Government should continue to focus on fiscal consolidation path or keep the deficit numbers constant for the next two years before reducing it further and try to propel growth. Sticking to a particular number is not that important in the current scenario. The policy makers should thus strive to make specific country-mandated fiscal rules which are credible, transparent and achievable for India!

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