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An Overview of India's Fiscal Deficit Trends and Strategies in Post Covid Era

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Abstract

The fiscal deficit directly impacts a country's growth, price stability and inflation. This study examines the trends of fiscal deficit in India and critically analyses the policies and programs implemented to manage the deficit in the post-COVID era. The research utilizes the secondary data. The secondary data is obtained from various sources such as the Economic Survey, Controller General of Accounts, and Handbook of Statistics on theIndian Economy. Time series data spanning from 2000-01 to 2021-22 is considered to study and analyze the trends of the central government's deficit as a percentage of GDP. Additionally, the study focuses on a critical evaluation of the policies and programs implemented to manage the deficit in the aftermath of the COVID-19 pandemic. The study has future relevance as it will provide insight into charting a path towards fiscal consolidation and long-term economic resilience.

Keywords: Fiscal Deficit, COVID–19, fiscal policy, Trends, Strategies

1.Introduction

The post-COVID-19 era consists of mitigation strategies to overcome the economic dent of the pandemic over the period. As for that time, during that period, in the circumvent of fear of recession most developing countries had infused massive stimulus packages, to maintain the liquidity of the economy which has haunted them in a post-COVID era in the form of inflation and huge fiscal deficits. The fiscal deficit represents the disparity between the

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government's total revenue and total expenditure. It emerges as a negative balance when government spending exceeds the inflow of tax and other revenues. The trend in fiscal deficit refers to the direction and pattern of changes in the fiscal deficit over a specific period. The trend provides insights into the fiscal health and management of a government, indicating its ability to balance expenditure and revenue and its overall fiscal sustainability. The Indian government has also faced the heat of economic turmoil in the pandemic and post-pandemic era, and the same has been reflected in the alarming fiscal deficit quantitative value. During the pandemic era, the government has opted for bailout packages of 20 Lakh crore which stands for 10% of GDP. However, by the time pandemic declined, the government already has been faced with a fiscal deficit of 6.8% which was revised from 9.5%. Hence to curb the deficit, the government has taken various initiatives including cutting down on subsidies and tax collection on a prima facie basis with infrastructure development in the long run. Henceforth, the paper has analysed the Indian Fiscal deficit concern in two parts namely Fiscal deficit trends and the critical analysis of Government strategies to curb the fiscal deficit. Furthermore, for analysing the government initiatives in the context of fiscal deficit, it is imperative to understand the Indian fiscal deficit trend and the reason for same. To begin with, in the case of India its fiscal performance trends could be summarised by the following Figure 1:

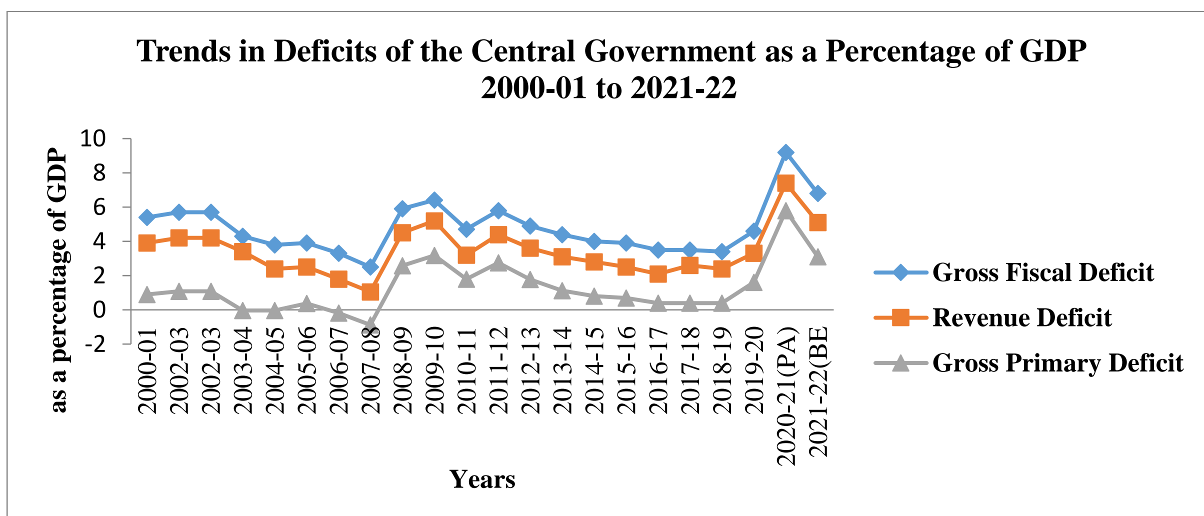

Figure 1: Trends in Fiscal Deficit over 20 years

Source: Compiled from Secondary Data

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The fiscal deficit trend of India reflects that it has fallen by about 2.54% of GDP in the financial year 2007-08 due to the USA recession crisis. The government introduced various financial stimuli to boost growth which resulted in a rise in fiscal deficit to 6.6% for the year 2009-10 and then the economic growth lowered it to 5.9% in the year 2011-12.Furthermore, the growth rate of central government in comparison to fiscal deficit could be summarised as follows:

Table 1:GDP in comparison to fiscal deficit

Items	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21 PA***	**2021-22 BE#**
Revenue receipts	15.0	4.4	8.2	8.4	-3.1	9.6
Gross tax revenue	17.9	11.8	8.4	-3.4	0.7	9.5
Net tax revenue	16.7	12.8	6.0	3.0	4.9	8.5
Non-tax revenue	8.6	-29.4	22.3	38.8	-36.4	16.8
Non-debt capital receipts	3.8	77.0	-2.5	-39.2	-16.0	226.2
Total non-debt receipt	14.4	7.7	7.4	5.2	-3.6	17.0
Total expenditure	10.3	8.4	8.1	16.0	30.7	-0.8
Revenue expenditure	9.9	11.1	6.8	17.1	31.3	-5.1
Capital expenditure	12.5	-7.5	16.9	9.1	26.5	30.5

Source: Union Budget Documents and CGA

BE Budget Estimate,

PA: Provisional Actuals

*Rate of growth vis-a-vis 2019-20 Actual

Rate of growth vis-à-vis 2020-21 PA

1.2. Cause of Indian Fiscal Deficit Trend

On analysing the trend, it could be construed that the trend of fiscal deficit in India has been influenced by several factors, contributing to its persistently high levels. One significant reason is the low tax-to-GDP ratio, which has remained around 10-11% over the past 20 years. In contrast to countries like Sweden, the UK, France, and South Africa, where the

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tax-to-GDP ratio ranges from 23% to 26%, India's relatively low ratio emphasizes that the government collects less revenue, resulting in a higher fiscal deficit. This has implications for investment rates and GDP growth, as lower revenue limits the government's capacity to fund development initiatives and infrastructure projects

Another factor contributing to the high fiscal deficit is the narrow tax base in India. A vast majority of Indians do not pay income taxes, with only around 4% of the population filing income tax returns. Instead, the Indian government heavily relies on indirect tax collections, such as the Goods and Services Tax (GST). This heavy dependence on indirect taxes further constrains revenue generation and widens the fiscal deficit. Similarly, on the expenditure side, high subsidies, particularly in food, fertilizers, and petroleum, contribute significantly to the fiscal deficit. Expenditure on these items reached approximately 3% of GDP in the fiscal year 2020-21. The subsidy bill for food, fertilizers, and petroleum is projected to be INR 532,446.79 crore for the fiscal year 2022-23. These subsidies, while important for social welfare, strain the government's finances and contribute to the widening fiscal deficit. Finally, another factor that impacts the fiscal deficit is the presence of off-budget financing. It is argued that the actual fiscal deficit figures may be even higher because certain government expenditures are funded through "off-budget" items. This means that the true fiscal deficit surpasses the level presented in the budget, as the additional expenditure is not accounted for in official calculations.

Furthermore, India's high debt-to-GDP ratio, projected to reach 84% by the end of 2022, poses a challenge. The increased debt burden leads to higher interest payments, with interest payments of the government reaching 3.1% of GDP or INR 7.31 lakh crore in 2021-22. This further adds to the fiscal deficit.

However, with the recovery of the world economy, India's fiscal deficit for the previous financial year, which ended on March 31, narrowed from 6.7% to 6.4% the previous year. This improvement was primarily attributed to robust tax receipts and some fiscal indicators. Thereupon government has adopted various majors to balance the deficit which could be categorised into changes in the Tax regime, subsidy management and CAPEX in various sectors.

Even after that, India’s fiscal deficit is the highest among the G-20 countries for the year 2022-23. Hence, it creates a scope to critically analyse the strategies adopted by the

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government in post COVID era to reduce it by 3% as per the fiscal responsibility and budget management (FRBM) Act, 2003. Hence the paper has covered the following objectives:

1. Trends of Fiscal deficit In India
2. Critical analysis of the policies and programmes to manage fiscal deficit post COVID.

2. Literature review

2.1Fiscal reform Post COVID-19

In the context of a high Fiscal deficit, the major three classical steps included to reduce the fiscal deficit are namely, reduction in government spending, Increase in tax base and faster economic growth. According to Leam (2023), the government must employ strategic approaches to leverage support in a manner that accelerates ongoing economic transformations or introduces new shifts required for sustainable and resilient growth. This approach ensures that fiscal measures are effectively aligned with the long-term goals of economic development and transformation.

However, in addition to the essential task of attaining sustainable public finances, governments must prioritize the alignment of fiscal stimulus measures with the segments that have the greatest potential to drive economic recovery. In India, the Information Technology (IT) and Digital Services sector, infrastructure development, spanning transportation networks, power generation, and urban development present a vital avenue for stimulating demand, creating jobs, and enhancing productivity across sectors. However, the infrastructure development in these sectors requires further investment with a possibility of high revenue in the long term and an enhanced fiscal deficit in the short term. In the case of India, it is already dealing with a high fiscal deficit, and CAPEX requires to be balanced with the reduction in expenditure and increase in tax collection. Hence for an efficient implementation of a long-term plan, there is a need for effective short-term measures in place to curb the fiscal deficit.

2.2 Restoring Financial Sustainability in post COVID era

Investors and taxpayers required a certain level of confidence in the fiscal management of the country for the continuation of financial expenditure. As per the OECD report on "Financial Sustainability: Public Sector Learning (2023), The countries which are engulfed

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in large fiscal deficits with their bailout packages during the pandemic require a credible deficit reduction plan to avoid financial market failure. However, IMF in its report on Fiscal deficit strategy (2023) has emphasised that the countries need a combination of defensive (cutting out expenses) and offensive (R&D and Infrastructure expansion) approaches to mitigate the fiscal deficit for a sustainable economy. In a different era, Denmark (1983-86), Ireland (1987-89) and Finland adopted expansion strategies to reduce their fiscal deficit which has paved the path to overcoming the deficit and inflation issues in the long run.

The one common theme in the fiscal deficit reduction plan of all these countries included the well-controlled expansion measures, which lowered the governed debt instrument's risk premium resulting in high investment with lower interest and tax rates. Hence, it could be concluded that the measures for fiscal consolidation could be expansionary to signal a decisive and permanent change in fiscal policy for a sustainable economy.

However, according to Sudhanan (2017), the fiscal deficit could be handled more efficiently if the subsidies, taxes and transfers are tackled properly. On it contrary, McElwee et al. (2020) have emphasised that a knee-jerk reaction to increase taxes and cut down subsidies only does the window dressing for the deficit which later on leads to market failure and recession.

Hence, it could be construed that the reduction of fiscal deficit includes cutting off subsidies and increasing tax rates as a proven defensive measure. However, countries, with efficient planning and implementation from the centre to state and local level can prefer offensive measures with expansion with investments in R&D and infrastructure.

3.Critical Analysis of Government's Strategies to Reduce Fiscal Deficit in India

India has adopted a mixed strategy to overcome the fiscal deficit gap. As their initial step for mitigation measures, the country has opted for tax reforms and a boost for CAPEX with subsidies cut-off. The finance minister has emphasised that the country has chosen the traditional tax-subsidiary strategy as the first layer to prefer stability over disruption with infrastructure expansion as the main tool the government has periodically reviewed and modified Interest Subvention Scheme for Crop Loans, the PAHAL scheme for Direct Benefit Transfer for LPG (DBTL) and the MANREGA scheme to reduce its revenue expenditure on social securities. In India, the government's expenditure on subsidies is 2.1%

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of the total GDP in the year 2023, which has been planned to be reduced to 1.5% by the year 2024-25. Curbing social security schemes, though looks like a straightforward approach for expenditure reduction, in the long term has its social-economic consequences, if not implemented strategically.

Additionally, the government has cut down on the major contributors to fiscal deficit namely, Ujwal Discom Assurance Yojana, which has a financial revival package for the development of state-owned electricity distribution companies. However, the government has not provided any alternative plan as a mitigation strategy for the loss in infrastructure development with this subsidy cut down. Road and electricity are the basic roots of infrastructure development, their subsidy cut down will impact the government's second layer (first tax subsidy) plan to develop the infrastructure for the influx of investment to reduce the fiscal deficit.

Similarly, Pradhan Mantri Garib Kalyan Yojana (PMGKAY) has been merged with the National Food Security Act. However, there has been a lack of technological integration for the merged and newly launched schemes which has imposed a question on the consequences of the merger and its results.

According to Leam (2023) in the present post-COVID era, there is a need to implement revenue enhancement and cost-containment strategy hand by hand for sustainable economic growth. India has given more emphasis on cost containment with subsidy reduction and foregoing tax exemptions. Additionally, the digitalisation of tax collection has not been holistically implemented which leads to various loopholes for escape. According to the Indian Income Tax Department in the year 2022, only 6.25% of people paid tax. Hence lack of a concrete taxation system conveys a burden on genuine taxpayers. At the same time, the taxation strategy has not been proven to be a major contribution to fiscal deficit reduction in the case of India due to a lack of efficient tax collection strategy at the place.

As the next layer to their proposition, the government has opted for infrastructure development with a 33% hike in the CAPEX to 10 lakh crores, which needs an influx of funds through FDI and domestic investments. The government need to convey a determination and a concrete strategic plan to boost the investor's confidence. The government has opted for various disinvestment plans, public-private partnerships, and

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asingle tax window with GST, start-up India, Make in India andstrategic alliance with other countries to bring investment to home.

4.Analysis of the Literature:

According to Chrystal and Dowd (2023), In the post-COVID era, most economists are concerned about the measures India has opted to fulfil its commitment to International Monetary Fund as a creditor, which will lead to a debt crisis with perils to compound the economic crisis. Even if the Indian government manages to steer clear of defaults, the escalating levels of public-sector debt can potentially hinder economic recovery if not effectively managed.

Industries like automotive manufacturing, construction, and transportation have experienced substantial disruptions in demand and supply chains due to the crisis, necessitating a fundamental restructuring. To address these challenges, governments can engage in partnerships with industry associations and prominent companies in these sectors to establish shared strategic goals and focus on joint investments. This collaboration aims to support the adoption of reinvented business models, foster agility, and enhance competitiveness. By working together, governments and businesses can navigate the economic transformation with a unified approach and drive sustainable growth in these key sectors.

5. Conclusion and Recommendations

In conclusion, to address India's fiscal deficit, it is recommended to focus on the rationalization of subsidies and ensure their targeted delivery, which can help control excessive spending. The tax system should be improved by enhancing compliance, introducing wealth and property taxes, and strengthening measures against tax evasion. Another suggestion is to generate additional revenues by monetizing idle assets, specifically vacant land owned by government entities. Adhering to the recommendations provided by the 15th Finance Commission regarding fiscal consolidation is crucial. Furthermore, engaging in a parliamentary debate on amendments to the FRBM Act and reinforcing compliance with the act while increasing the costs associated with deviation is important. As the country moves beyond the post-COVID era, prioritizing fiscal consolidation and

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reducing the fiscal deficit to a sustainable level becomes essential for long-term financial stability and sustainable economic growth.

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