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Fiscal Policy in Crisis in India: A Lesson for the Global Economy

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Fiscal Policy in Crisis in India: A Lesson for the Global Economy

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Fiscal management is essential for price stability, stable economic growth and sustainable fiscal position. Thus, given objective of a prudent fiscal management, the operational instruments need not be static but necessarily should be dynamic in nature, evolving with economic circumstances. Illustratively, COVID-19 pandemic was one such instance, when the Central Government had to relax its pre-determined glide path towards fiscal consolidation in favour of fiscal stimulus to sustain and revive the sagging economy.

This paper attempts to document India's prudent fiscal response to economic disruption caused due to COVID-19 pandemic and its impact on government efforts of fiscal consolidation. This paper is organized into five sections. Section 2 provides a brief account of Central Government efforts towards fiscal consolidation and the impact of COVID-19 pandemic on them. In the next section, India's unique approach to fiscal stimulus in the times of global pandemic has been documented. Section 4 examines how India fares among its global peers in fiscal management during the crisis and the recovery thereafter. Finally, a brief conclusion has been presented.

2: A brief account of Indian efforts towards fiscal consolidation

In India, the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, effective from July 5, 2004 marked the beginning of a sustained effort towards fiscal consolidation. However, the seeds of FRBM Act, 2003 were planted in 1990s. India's introduction of a fiscal rule dates back to September 1994 when *ad-hoc* Treasury bills that were automatically monetising budget deficit were phased out by the RBI. In 1997, the system to issue *ad-hoc* Treasury bills was replaced by a system of ways and means advances (WMA). Finally, the initiative to set up a modern fiscal legislation was considered in December 2000.

The objectives of FRBM Act, 2003 were the elimination of revenue deficit (RD) by 2008-09 and reduction of fiscal deficit (GFD) to no more than 3 per cent of GDP at the end of 2008-09.

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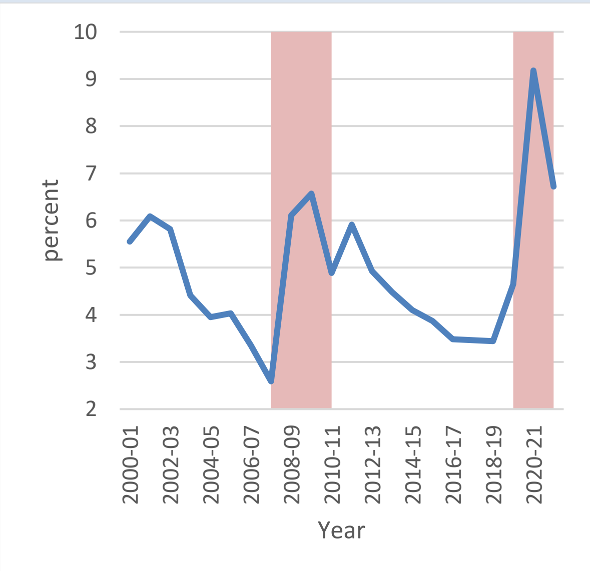
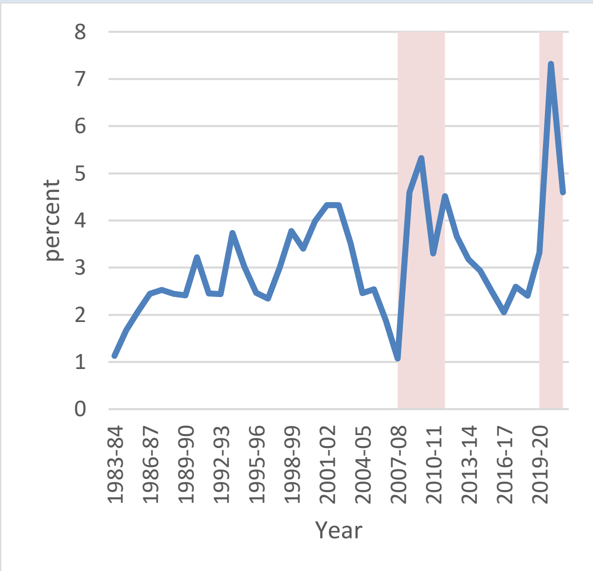
India was well on path to achieve these goals, until the Global Financial Crisis (GFC), 2008 necessitated a fiscal stimulus, thus pushing Central government GFD from 3 per cent in 2007-08 to over 6 per cent of GDP in subsequent years. As the economy recovered, the GFD to GDP ratio moderated gradually, from a peak of 6.6 percent in 2009-10 to 3.4 percent in 2018-19. However, fiscal consolidation was again disrupted by the COVID-19 pandemic. In an economy that was facing recurring economic lockdowns and health crisis, fiscal stimulus became a necessity. Thus, the GFD rose from 3.4 percent of GDP in 2018-19 to 4.6 percent in 2019-20. It then significantly increased to 9.2 percent of GDP in 2020-21 (Graph I).

The RD to GDP ratio reflected a similar trend. The Central Government was moving steadily towards that target of eliminating RD, when the GFC derailed those attempts, pushing RD to GDP ratio from 1.1 percent of GDP in 2007-08 to 4.6 percent in 2008-09. As the impact of GFC subsided, the RD fell gradually from 3.2 percent of GDP in 2013-14 to 2.4 percent in 2018-19, following a glided path. In the wake of COVID-19 crisis, the Central government moved to support the economy and its RD went up from 2.4 percent of GDP in 2018-19 to 7.3 percent of GDP in 2020-21 (Graph II).

Graph I: Central Government Gross Fiscal Deficit (GFD) to GDP ratio of India (percentage of GDP)



Graph II: Central Government Revenue Deficit (RD) to GDP ratio of India (percentage of GDP)

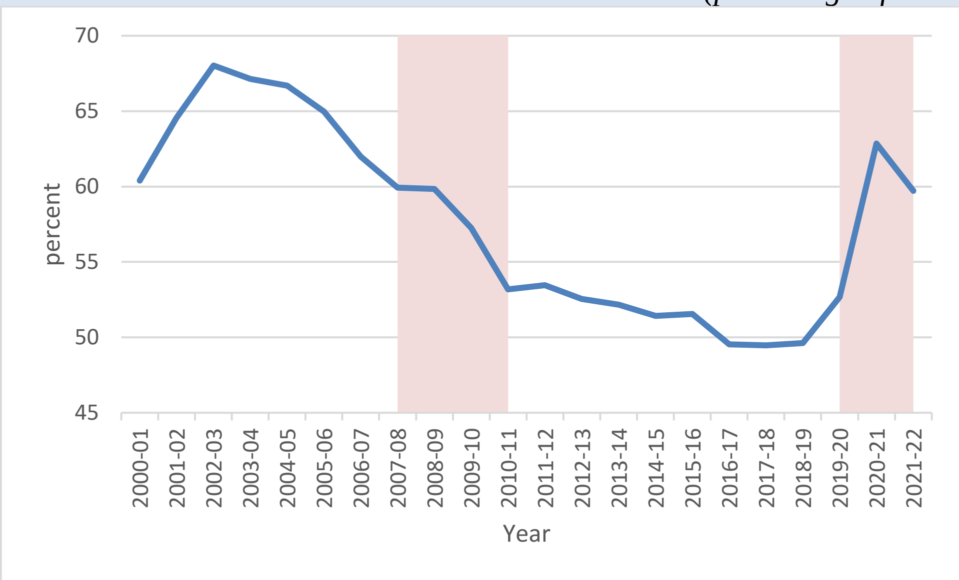


Note: Shaded portions reflect the crisis phase of the economy
Source: Computed by author based on data from Handbook of Statistic on Indian Economy, RBI

The Central government debt to GDP ratio, one of the primary instruments to finance Central government deficits, reflect the disruption caused due to crisis phase of the economy. The declining debt to GDP ratio in early 2000s was halted for a brief period at 59.9 percent of GDP due to GFC in 2008-09, following which, it resumed its downward trend, until 2018-19, to 49.6 percent of GDP. Owing to COVID-19 pandemic, the Central government debt to GDP ratio shot up from 52.6 percent of GDP in 2019-20 to 62.8 percent in 2020-21 (Graph III). Hence, it is to be noted that efforts of fiscal consolidation had been periodically interrupted by economic crisis. India, however, continued its march towards fiscal prudence gradually after the crisis.

Graph III: Debt to GDP ratio of Central Government

(percentage of GDP)

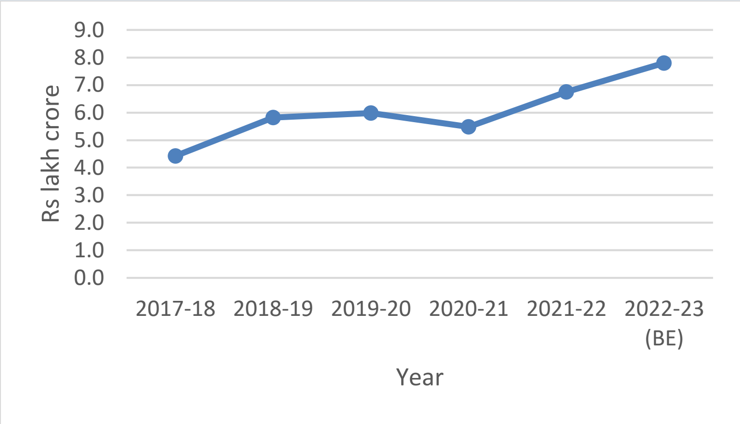


Note: Shaded portions reflect the crisis phase of the economy
Source: Computed by author based on data from Handbook of Statistics on Indian Economy, RBI

Efforts of fiscal consolidation after the GFC were undertaken in a well-planned manner. Fiscal consolidation received a renewed impetuous from 2014, when an era of reforms was ushered in. For instance, in May 2016, the Government of India constituted a five-member committee (Chairperson: N.K. Singh) to review the working and functioning of FRBMA. On the basis of the recommendations of the Committee, the FRBM (Amendment) Act, 2018, was enacted, mandating Central government GFD to reach 3 percent of GDP by March 31, 2021, and Central government debt to GDP ratio to reach 40 percent by 2024-25. The amendment also specified the escape clause which mentioned certain conditions under which the annual GFD to GDP ratio can deviate from the target by 0.5 percent of GDP. This escape clause was utilized in subsequent years and during COVID-19 pandemic to support the economy during slowdown.

The implementation of the Goods and Services Tax (GST), from July 1, 2017, which merged 17 different Central and state government taxes into a single indirect tax was another such reform. Despite initial teething issues, the GST collections remained buoyant as the economy opened up gradually after the pandemic (Graph IV). The total monthly collections (Centre and states) under GST are estimated to be around Rs. 1.45 lakh crore in the month of October 2022.

Graph IV: GST collection of Central Government



Source: Budget Document, GoI, 2022-23

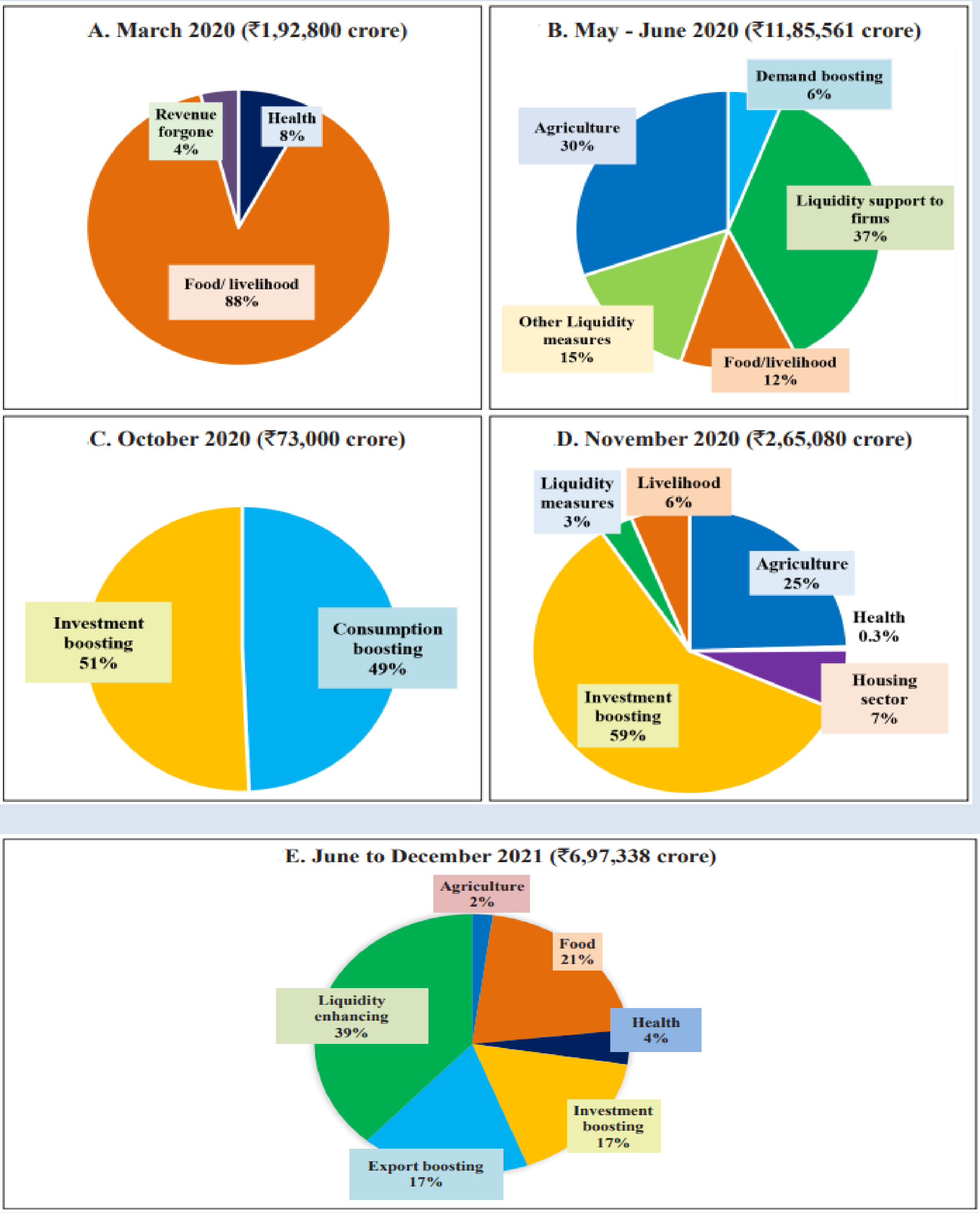
The fiscal stimulus provided during COVID-19 was well-planned, following calibrated approach to ensure that the stimulus provided by the government was not a wasteful or economically detrimental exercise, but a buffer in the times of crisis and a platform of sustained economic growth in the medium to long term. Thus, the opportunity that the crisis provided was not wasted but availed efficiently for the growth of the economy.

3: The Structure of Indian Stimulus

India adopted an optimizing approach to provide COVID-19 stimulus, prioritizing safety nets and livelihoods in the initial stages of lockdown and eventually shifting focus to reviving economy through sectoral support and capital expenditure (Figure I).[2] The ultimate aim of this strategy was targeted outcomes for marginal sections of the society, both in the short as well as the medium term. Such an aim was pursued using a multi-pronged strategy of food subsidies, livelihood support and health support in initial phase, and stimulating economic growth in medium term.

[2] Economic Survey (Government of India, 2021-22) described the stimulus strategy as "Barbell Strategy", that combined a bouquet of safety-nets to cushion the impact on vulnerable sections of society/business, with a flexible policy response based on a Bayesian updating of information.

Figure I: Phased approach to economic stimulus provided during COVID-19 pandemic

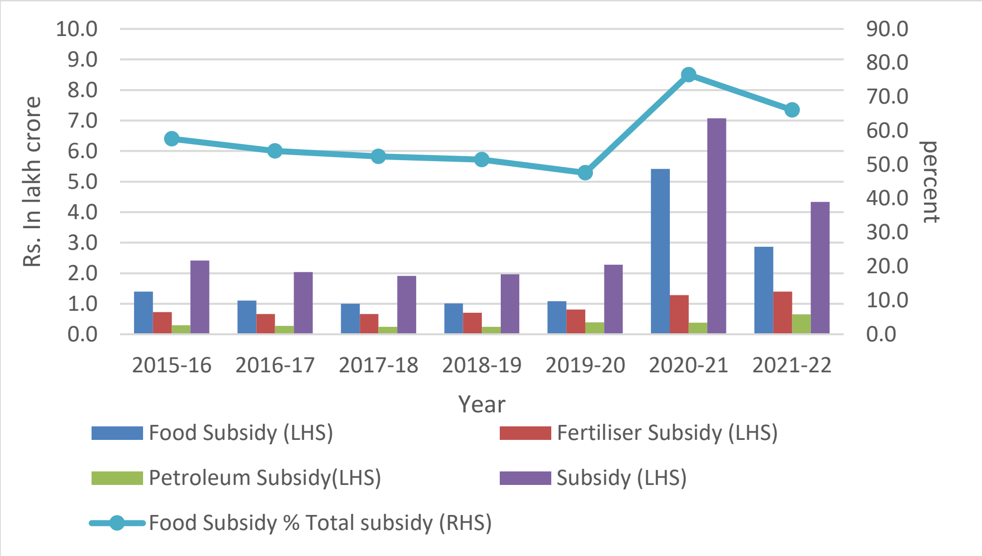


Source: Economic Survey, GoI, 2021-22

Food Support

In the initial period of lockdown, beginning from March, 2020, the stimulus encompassed measures such as expansion of food subsidy and providing livelihood to the people worst affected due to lockdown. Pradhan Mantri Garib Kalyan Ann Yojana (PMGKAY), which has so far been rolled into seven phases, was initiated, providing free 5 kg of food grains per month to 80 crore beneficiaries. In first year of pandemic, Rs 5.4 lakh crore were spent on food subsidies, constituting 76.4 percent of all subsidies granted that year (Graph V).[3]

Graph V: Amount spent on subsidies by Central government and the share of food subsidies in total subsidies



Source: Various budget documents, GoI, 2021-22

In the wake of supply chain disruption caused due to lockdown, the government adopted a technologically robust Public Distribution System with an automated supply chain management and Aadhaar seeding of around 100 percent of the National Food Security Act (NFSA), 2013 ration cards. One Nation, One Ration Card (ONORC) Scheme was leveraged to ensure portability of ration card, especially for migrant workers.[4] Lowe, Nadhanael and Roth (2021) demonstrated how easing of inter-state supply chain constraints for essentials like food grains kept prices at pre-pandemic levels and enabled food security during COVID-19. Bhalla, Bhasin and Virmani (2022) concluded that such measures were instrumental in ensuring that extreme poverty remained low at around 0.8 percent, at the pre-pandemic level.

Employment

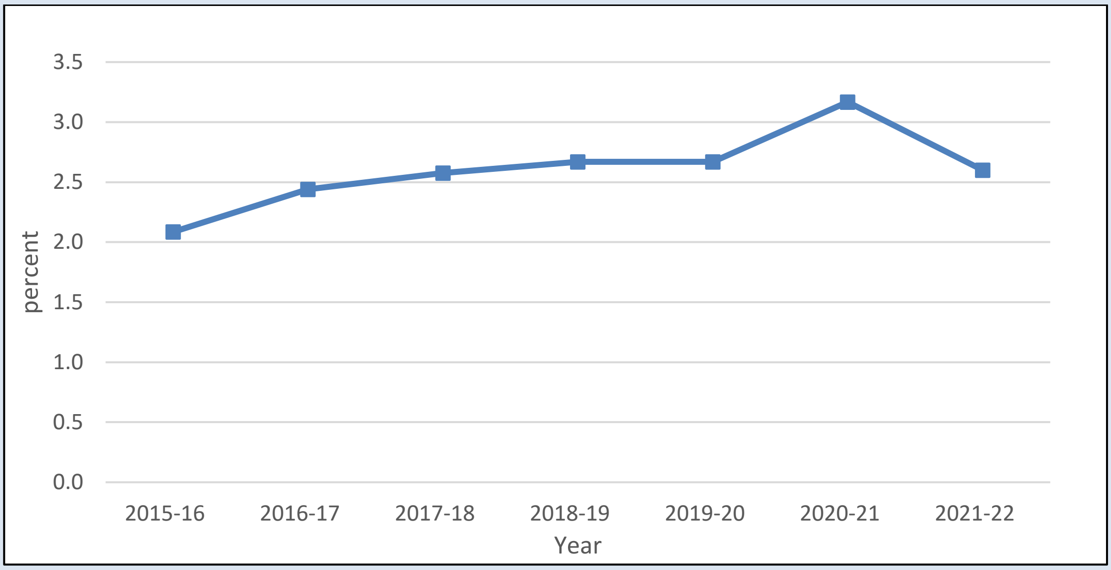
In order to prevent a crisis of livelihood, Mahatma Gandhi National Rural Employment Guarantee Act, 2005 (MNREGA) was ramped up. MGNREGA provides right to livelihood in rural areas, with 100 days of guaranteed unskilled labour. The minimum wages under MGNREGA were increased from Rs 182 per day to Rs 202 per day for supporting 13.62 crore

[3] Budget Documents, GoI, 2022-23

[4] Press Release, Press Information Bureau, GoI https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1742772

families.[5] Thus, MGNREGA allocation increased from Rs 71,686 crore in 2019-20 to Rs 1.1 lakh crore in 2020-21. As a result, its share in total expenditure of Central government rose from 2.6 percent to 3.1 percent within a year (Graph VI). This provided the required immediate support to rural economy and employment.

Graph VI: Share of expenditure on MGNREGA in total expenditure of Central Government



Source: Computed by author from various Budget Documents, GoI

Health Care

Fiscal support to health care sector was provided through 'COVID-19 Emergency Response and Health Systems Preparedness Package' of Rs 15000 crore. The aim was to reduce inequality in access to healthcare services, ramping up supply of essential material like personnel protection equipment (PPE) kits, face masks, training of health workers and increasing capacities of existing healthcare infrastructure. Meanwhile, efforts were focused on working closely with the private sector to accelerate development of COVID-19 vaccine. Mission Suraksha was launched with a stimulus package of Rs 900 crore to enable R&D in vaccine production.[6] In 2021-22, government allotted Rs 35,000 crore for COVID-19 vaccination programme. Under "The Liberalized Pricing and Accelerated National COVID-19 Vaccination Strategy", States/Union Territories (UTs) and private hospitals were allowed to

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[5] Press Release, Press Information Bureau, GoI
https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1608345

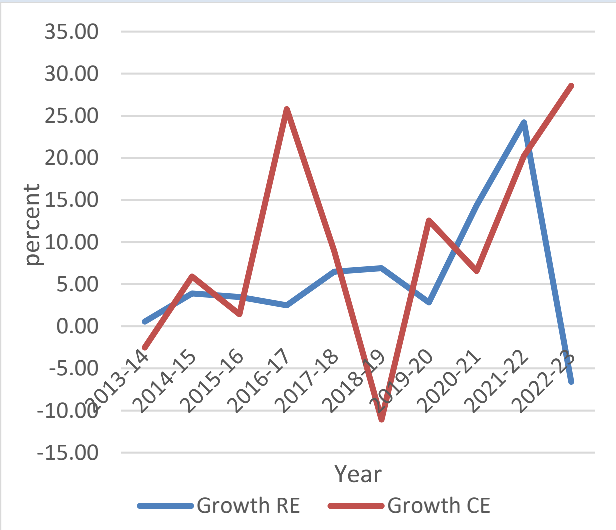
[6] Press Release, Press Information Bureau, GoI
https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1676998#:~:text=Government%20Launches%20Mission%20COVID%20Suraksha%20to%20accelerate%20Indian%20COVID%2D19%20Vaccine%20Development&text=The%20Government%20of%20India%20(GOI,COVID%2D19%20Vaccine%20Development%20Mission.

procure COVID-19 vaccine directly from manufacturers. 50 percent of monthly vaccine production by the domestic manufacturers was procured by Government of India, while the State Governments and private hospitals procured remaining 50 percent doses.[7,8] The vaccination program was implemented in a phased manner, with healthcare workers, elderly and people with co-morbidities given priority. This ensured equitable distribution of vaccine to people.

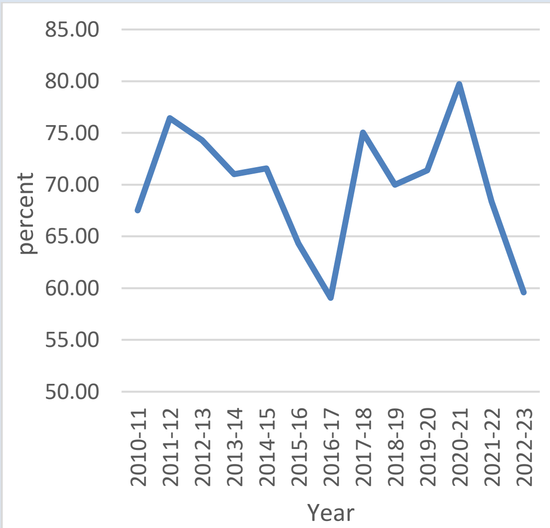
General Approach

In later phases, the focus of the fiscal stimulus gradually shifted to propelling the economy and maintaining sustained growth in medium and long term. Therefore, the emphasis shifted to boosting investment through Production Linked Incentives (PLI), greater investment in infrastructure through National Infrastructure Pipeline, National Asset Monetization Plan and public investment in health sector. As a result, the share of capital expenditure in total government expenditure reached highest since 2008-09 at 16 per cent in 2021-22 and increased further to 19 percent in 2022-23. This led to better quality of fiscal deficit (Graph VII and VIII).[9]

Graph VII: Real y-o-y growth rates of Revenue Expenditure (RE) and Capital Expenditure (CE) (percent)



Graph VIII: Share of Revenue Deficit in GFD (percent)



Source: Computed by author based on data from Handbook of Statistics on Indian Economy, RBI.

[7] In "The Revised Guidelines for Implementation of National COVID-19 Vaccination Program", Government of India procured 75 percent of monthly vaccine production and provided free to States and UTs, while rest could be procured by private hospitals.
[8] Economic Survey, GoI, 2022
[9] A good quality fiscal deficit implies lower share of revenue deficit in it

4: International Experience

Fiscal stimulus in the wake of economic slowdown due to COVID-19 pandemic in not unique to India. Almost all countries have adopted a policy of greater government intervention to support the economy. The USA congress had committed USD 4.6 Trillion to revive the economy in the wake of COVID-19 shocks.[10] As early as in July, 2020, EU leaders agreed on a €750 billion recovery effort, Next Generation EU, to help the EU tackle the crisis caused by the pandemic. Measures such as safety net provisions via pandemic crisis support (PCS) instruments, loan guarantees worth €25 billion and enabling fiscal flexibilities by activating the general escape clause in the EU fiscal rules were undertaken in addition to the above package. China also announced an estimated RMB 4.9 Trillion of discretionary fiscal measures which included spending on epidemic prevention and control, medical equipment, employment insurance, tax reliefs as well as public investment.[11]

Overall, AEs are spending 17 percent of their GDP (2020) in terms of revenue foregone and an additional 2.4 percent of GDP in terms of equity, loans and guarantees. The USA alone, had spent 25.5 percent of its GDP (2020) in terms of fiscal spending and revenue foregone, and an additional 11 percent of GDP in terms of equity, loans and guarantees.[12] As a result, deviation from fiscal consolidation has been observed globally (Table I).

Table I: General government GFD

(percent)

Countries	2018	2019	2020	2021	2022
US	5.3	5.5	14.5	10.9	4.0
UK	2.2	2.2	12.8	8.0	4.3
France	2.3	3.1	8.9	6.4	5.1
Germany	-1.9	-1.5	4.3	3.7	3.3
Canada	-0.4	0.0	11.4	5.0	2.2
Brazil	7.0	5.9	13.3	4.4	5.8
Russia	-2.9	-1.9	4.0	-0.8	2.3
China	4.3	6.1	9.7	6.1	8.9
South Africa	3.7	4.7	9.7	6.0	4.9
India	6.4	7.5	12.8	10.0	9.9

Note: Figures in parenthesis are change in percentage points from the previous financial year
Source: Fiscal Monitor, IMF (October, 2022)

However, a global comparison with select economies of the world suggest that India performed considerably well in controlling fiscal expansion in the times of crisis. Compared to major

[10] USAspending.gov (an official website of USA government) as on 20th October, 2022.
[11] IMF Policy tracker https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#C accessed on 20th October, 2021.
[12] Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic, IMF https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19

advanced and BRICS economies, GFD in India expanded by 5.3 percentage points over previous year in 2020, while for some advanced economies, like Canada and United Kingdom, fiscal expansion over the previous year was as high as 11.4 and 10.6 percentage points respectively.[13] Compared to its global peers, India is reducing its GFD gradually and marginally, indicting efforts towards soft landing.

In case of general government debt as well, the debt to GDP ratio of India increased by 18.7 percent y-o-y in 2020. This is well below the increase receded by nations like USA and Canada, where it grew by 23.6 and 53.1 percent respectively. Fiscal consolidation, in terms of debt management as well, is being pursued in a phased manner thereafter in most of the countries (Table II).

Table II: General government debt to GDP ratio

(percent)

Countries	2018	2019	2020	2021	2022
US	107.50	108.80	134.50	128.10	122.10
UK	84.50	83.90	102.60	95.30	87.00
France	97.80	97.40	114.70	112.60	111.80
Germany	61.30	58.90	68.00	69.60	71.10
Canada	88.90	87.20	117.80	112.90	102.20
Brazil	85.60	87.90	98.70	93.00	88.20
Russia	13.60	13.70	19.20	17.00	16.20
China	53.80	57.20	68.10	71.50	76.90
South Africa	51.70	56.20	69.00	69.00	68.00
India	70.40	75.10	89.20	84.20	83.40

Note: Figures in parenthesis are change in percentage points from the previous financial year
Source: Fiscal Monitor, IMF (October, 2022)

Conclusion

The key objective of fiscal policy in India has been sustainable economic growth. The fiscal policy created during the COVID-19 crisis, has been utilized to ensure inclusive economic growth and prioritizing immediate support to low income groups. It then gradually shifted focus to create avenues for employment generation and sustained economic recovery.

In comparison with its global peers, India is better placed in terms of fiscal space despite the stimulus during the crisis. Its deficit and debt expansion have remained modest, and is on a steady path towards normalization. In Budget 2021-22, a new fiscal roadmap was formulated by GoI, where GFD was targeted to reach 4.5 percent of GDP by 2025-26 from 6.9 percent in

[13] The percentage points were used since y-o-y growth rate were spurious results due to base effect which were difficult to compare.

2021-22. India’s approach to fiscal management demonstrated that fiscal consolidation is a means to achieving economic growth, and not an end in itself. India’s conduct of undertaking fiscal policy in a cautious and responsible way during COVID-19 has many lessons for other economies of the world.

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