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Fiscal Sustainability in India: An Assessment in Pre and Aftermath of Covid-19

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Abstract
The purpose of this research paper is to evaluate India's budgetary sustainability both before and after the COVID-19 pandemic. Global economies have been severely affected by the COVID-19 pandemic, and India is no exception. The country is facing significant fiscal issues as a result of rising costs for social security, health care, and economic stimulus plans. This study examines shifts in India's fiscal situation prior to the pandemic and the consequences encountered in its aftermath by examining fiscal variables such as state debt, budget deficits, and revenue trends. Using a mixed-method approach, the study combines qualitative evaluations derived from government reports and economic forecasts with quantitative data analysis. Initial results show that there has been a decline in fiscal indicators since COVID-19, which has been made worse by lower revenue generation and higher demands for expenditure.

Keywords: Fiscal Sustainability, Covid 19, India, Budget etc.

Introduction
Fiscal sustainability is the ability of a government to maintain public finances at a credible and serviceable position over the long term. Ensuring long-term fiscal sustainability requires that governments engage in continual strategic forecasting of future revenues and liabilities, environmental factors and socio-economic trends in order to adapt financial planning accordingly. High and increasing debt levels are harmful to governments' fiscal positions and can cause a vicious cycle of growing debt, reducing the potential for economic growth as funds are diverted away from productive investments (OECD, 2013).

Fiscal sustainability in India-
Rising expenditures have been a primary concern of fiscal policy in many countries over the past two decades. Examination of fiscal sustainability is imperative, particularly in federal countries where both national and sub-national governments continuously borrow and debt stands at relatively high levels. High debt levels restrict the government's choices in issuing debt, imposing taxes, and printing money to correct the deficit (Kia, 2008). India is a federal country where power and responsibility for taxation and expenditure are divided between the Union (central) and state governments. This is also known as fiscal federalism, which is the most important pillar for sharing taxation and expenditures between central and state governments. In India, the central government has more power to tax, whereas state governments have limited taxation power and greater expenditure responsibilities. This leads to vertical (central–state disparities) and horizontal (inter-state disparities) imbalances. The central government collects revenue of around 63–64% while expenditure is only about 43%. State governments collect revenue of only around

36–37% but incur approximately 57% of expenditures (Rao, 2017). To reduce these imbalances, the Constitution of India gives the right to states to share revenues (i.e., tax devolution) between the central and state governments, along with intergovernmental transfers in the form of grants-in-aid and centrally sponsored schemes through various channels as per the Finance Commission recommendation (Rao, 2007). The Constitution of India also allows state governments to borrow from various external sources under a ceiling and with central government approval. Indian states rely mostly on fiscal transfers/debt, along with their own revenue generation through limited taxes and non-tax sources. Thus, they may end up in weak fiscal health or fiscal unsustainability, which prevents all fiscal consolidation measures (Reddy and Reddy, 2019).

India has adopted the Fiscal Responsibility and Budget Management (FRBM) Act of 2003 in July 2004. It has been amended from time to time. In the latest endeavour, comprehensive amendments to the FRBM Act have been done through the Finance Act of 2018. The review report stipulates a debt–gross domestic product (GDP) ratio of 40% and 60% for the central and combined government, respectively, by no later than financial year 2022–2023. In addition, fiscal deficit of the central government should also be reduced to 2.5%. The escape clauses, permitting a maximum deviation of one-half per cent of GDP from target deficit, can be invoked in case of conditions such as national security, act of war, national calamity, collapse of agricultural structure, reforms in the economy, decline in real output growth etc.

The question of debt sustainability in India has been on the radar of policymakers for a considerable period of time. This was considered to be the main cause of the economic crisis in 1991.Despite several attempts to control deficits and debt, the problem has continued to haunt us.

Although the Constitution under Article 292 requires the Parliament to fix the volume of borrowing from time to time, formally, the rule-based fiscal policy came to be followed after the Fiscal Responsibility and Budget Management (FRBM) Act was passed in 2004.

In May 2016, the government set up a committee under NK Singh to review the FRBM Act. The committee recommended that the government should target a fiscal deficit of 3 per cent of the GDP in years up to March 31, 2020, cut it to 2.8 per cent in 2020-21 and to 2.5 per cent by 2023.

Research Methodology

This research is based on mixed-method approach, combines qualitative evaluations derived from government reports and economic forecasts with quantitative data analysis. The necessary facts have been collected through books, journals and the internet.

Objective of the study

- To evaluate India's budgetary sustainability both before and after the COVID-19 pandemic.
- To examine shifts in India's fiscal situation prior to the pandemic and the consequences encountered in its aftermath.

Pre Covid-19-

Fiscal sustainability across Indian states using annual data from 1980 to 81 to 2017-18. Though earlier studies on fiscal sustainability focus mainly on the aggregate Indian economy, few examine India at the sub-national level, that is, by state, region, and income level. The debt position of the state governments in India, which deteriorated sharply between 1997-1998 and 2003-2004, has witnessed significant improvement since 2004-2005. Debt sustainability analysis based on empirical estimation of inter-

temporal budget constraint and fiscal policy response function in a panel data framework, covering 20 Indian states for the period 1980-1981 to 2015-2016, indicates that the debt position at the state level is sustainable in the long run. The increase in contingent liabilities of states and take-over of large chunk of these liabilities through debt restructuring of State Power Distribution Companies, however, would adversely affect the debt position of states.
Before the coronavirus disease (COVID-19) pandemic struck, India's public debt was assessed as high yet sustainable. The last Article IV staff report published by the International Monetary Fund in December 2019 had found that favorable debt dynamics and financial repression made the debt path sustainable, as the statutory liquidity requirement had created a captive domestic market for debt, which limits the interest cost of debt. Risks had been further mitigated because public debt is denominated in domestic currency and predominantly held by residents. The primary risk to debt sustainability was mainly from shocks to real gross domestic product (GDP) growth and fiscal slippages. In 2020, Finance Minister, Nirmala Sitharaman used the escape clause provided under the FRBM Act to allow the relaxation of the target. Finance Minister revised the fiscal deficit for FY20 to 3.8 per cent and pegged the target for FY21 to 3.5 per cent.

Important reports by IMF regarding Fiscal sustainability-

1. Global Financial Stability Report - The global financial stability report is prepared by the IMF (International Monetary Fund). The IMF prepares the global financial stability report twice a year- April and October.

The recent Global financial stability report 2023 was published in April. The Global Financial Stability Report provides an assessment of the global financial system and markets, and addresses emerging market financing in a global context. It focuses on current market conditions, highlighting systemic issues that could pose a risk to financial stability and sustained market access by emerging market borrowers. The Report draws out the financial ramifications of economic imbalances highlighted by the IMF's World Economic Outlook. It contains, as special features, analytical chapters or essays on structural or systemic issues relevant to international financial stability.
In year 2019, before COVID-19 the Global Financial Stability Report (GFSR): lower for longer identifies the key vulnerabilities in the global financial system as the rise in corporate debt burdens, increasing holdings of riskier and more illiquid assets by institutional investors, and growing reliance on external borrowing by emerging and frontier market economies. The report proposes that policymakers mitigate these risks through stricter supervisory and macro prudential oversight of firms, strengthened oversight and disclosure for institutional investors, and the implementation of prudent sovereign debt management practices and frameworks for emerging and frontier market economies.

2. Fiscal Monitor - The Fiscal Monitor is prepared twice a year by the IMF's Fiscal Affairs Department. Its projections are based on the same database used for the World Economic Outlook (WEO) and the Global Financial Stability Report (GFSR).

The October 2019 edition of the Fiscal Monitor focuses on the design of fiscal policies for climate mitigation at the domestic and international level. This report emphasizes the environmental, fiscal, economic, and administrative case for using carbon taxes, or similar pricing schemes such as emission trading systems, to implement climate mitigation strategies. It provides a quantitative framework for understanding their effects and trade-offs with other instruments and applies it to the largest advanced and emerging economies. Alternative approaches, like "feebates" to impose fees on high polluters and give

rebates to cleaner energy users, can play an important role when higher energy prices are difficult politically. At the international level, the report calls for a carbon price floor arrangement among large emitters, designed flexibly to accommodate equity considerations and constraints on national policies. The report estimates the consequences of carbon pricing and redistribution of its revenues for inequality across households. Strategies for enhancing the political acceptability of carbon pricing are discussed, along with supporting measures to promote clean technology investments.

Post Covid-19

The Coronavirus pandemic, emerging from the last week of March 2020, has rendered the situation uncontrollable. The severe lockdowns in the first phase of the pandemic in the first half of 2020-21, and the reimposition of restrictions on economic activity in the second phase, drained the sources of revenue; at the same time, the large public intervention to save lives and livelihoods and the nation-wide roll -out of vaccination required significant increases in public spending, causing both deficit and debt to climb to unsustainable levels. It is not merely the large deficits and debt that are cause for concern–the quality of deficits is equally important. The revenue deficit, which was just about 35-40% of the fiscal deficit in the early 1990s, has shot up to 70% in 2020-21. This implies that almost 70% of the borrowed funds are now used for meeting current expenditures.

Independent Fiscal Institutions: Worldwide Experience:

Creating an independent fiscal institution to monitor the conduct of fiscal policy and reporting to the Parliament is an important innovation to impart greater effectiveness in implementing sustainable fiscal policy. This strengthens with clear commitments to fiscal adjustment path and transparent medium-term fiscal framework (Kumar and Ter-Minassian, 2007).

These institutions assist in calibrating sustainable fiscal policy by making independent, objective and scientific analyses of fiscal policies for achieving the objectives of macroeconomic stability and sustainability. Their unbiased report to the Parliament helps to raise the level of debate and brings in greater transparency and accountability. They estimate the costs of various projects, programmes and policies and this helps to promote transparency and discourages populist shifts and improves accountability. Objective estimation of costs of programmes and realistic evaluation of budget forecasts help to raise public awareness about their fiscal implications and make the politicians and the public understand the extent and nature of the budget constraint.

At the end of 2021, 51 Fiscal Councils in 49 countries have been appointed to oversee the implementation of rule-based fiscal policy. While the common agenda of these institutions has been to promote sound fiscal policies as watchdogs, there is considerable diversity in the structure and functions they are assigned to perform. The important tasks they are assigned to perform include

1. Independent analysis, review and monitoring and evaluation of government's fiscal policies and programs;
2. Developing or reviewing macroeconomic and /or budgetary projections;
3. Costing of budget and policy proposals and programs, including the proposals in the election manifestos; and
4. Advising the policymakers on various policy options.

India experience:

Impact of COVID-19 on India's economy. India's GDP contracted 7.3% in fiscal year (FY) 2021 (ended 31 March 2021), and the Asian Development Outlook Supplement (July) 2021 projects growth of 10.0% in FY2022 as economic activity normalizes, before moderating to 7.5% in FY2023. The International Monetary Fund's latest World Economic Outlook Update 2021 published in July 2021 forecasts GDP growth of 9.5% in FY2022, and 8.5% in FY2023. The Reserve Bank of India projects GDP growth of 9.5% in FY2022

Significantly widened fiscal deficit to fight the pandemic. The government has significantly widened the fiscal deficit to fight the pandemic and support economic and social recovery. The central government increased expenditure amid falling revenue and expanded the fiscal deficit for FY2021 to 9.2% of GDP, revised upward from 3.5% of GDP budgeted in FY2020 but revised down from its revised estimate of 9.5% of GDP in February 2021. The fiscal deficit for FY2022 is budgeted at 6.8% of GDP. The central government plans to reduce its fiscal deficit gradually to below 4.5% of GDP by FY2026. The general government (including both central and state governments) fiscal deficit is estimated to have nearly doubled at 13.8% of GDP in FY2021 compared to 7.8% in FY2020. It is estimated to decline to 10.6% of GDP in FY2022.

Fiscal Council for India.

The 13th Finance Commission, while recommending the revised roadmap for fiscal consolidation, underlined the need for making the FRBM process more transparent and comprehensive, sensitive to exogenous shocks, and introducing mechanisms to improve monitoring and compliance. The Commission recommended the setting up of a committee to conduct an independent review of FRBM compliance, including the fiscal impact of policy decisions on the FRBM roadmap, to be presented along with the annual budget and medium-term strategy. The Commission recommended that the committee should, over time, transform itself into a full-fledged Fiscal Council (India, 2009; Para 9.65). The FRBM Review Committee too made a similar recommendation.

However, the Council appointed by the Finance Ministry would not have legislative scrutiny. Therefore, the Fourteenth Finance Commission recommended that the FRBM Act should be amended to enable the Parliament to appoint a Fiscal Council to monitor the fiscal management in the country. The Fiscal Council is supposed to bring out ex-ante fiscal implications of the budget proposals and their consistency with the Medium Term Fiscal Plan (MTFP) and rules (India, 2014, Para 14.101).

The Fifteenth Finance Commission went into the issue of strengthening the institutional process. It surmised that the previous Commissions have underlined the need to

1. Strengthen the budgetary process;
2. Move towards accrual accounting and
3. Standardize and consolidate the information on key fiscal variables across all levels of government to make it comprehensive.

The indicative functions suggested for the Fiscal Council are:

1. Providing multi-year fiscal forecasts;
2. Evaluating fiscal performance in relation to the targets;
3. Appropriateness and consistency of fiscal targets in the states;
4. Independent assessment of fiscal sustainability;

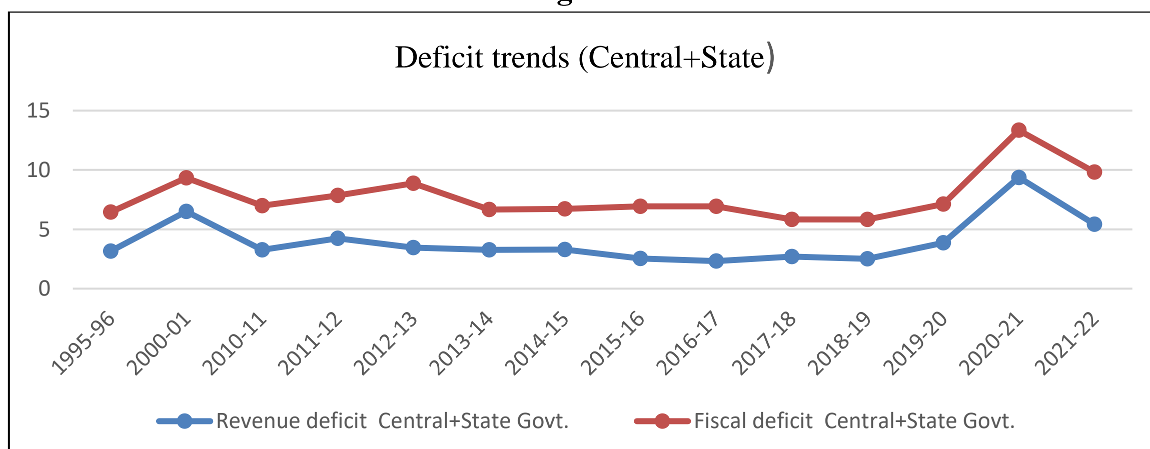
5. Making the assessment of fiscal policy statements under fiscal responsibility legislations;
6. Advising on the applicability of conditions applicability of escape clauses under fiscal responsibility legislations
7. Costing of policies and programs with significant fiscal implications;
8. Providing analytical support to the Finance Commissions;
9. Dissemination of their report and methodology employed to arrive at conclusions to the public. It made detailed recommendations to improve the budgeting and public finance management system and an independent fiscal council. Unfortunately, this recommendation has not found favour with the Government.

Figure 1: Trends in Deficits and Debt in India (% of GDP)

Year	Revenue deficit Central+State Govt.	Fiscal deficit Central+State Govt.
1995-96	3.15	6.44
2000-01	6.49	9.34
2010-11	3.26	7.00
2011-12	4.24	7.84
2012-13	3.46	8.88
2013-14	3.27	6.67
2014-15	3.30	6.71
2015-16	2.53	6.92
2016-17	2.32	6.92
2017-18	**2.71**	**5.83**
2018-19	**2.50**	**5.84**
2019-20	**3.87**	**7.12**
2020-21	**9.37**	**13.34**
2021-22	**5.42**	**9.81**

(Source: https://upstox.com/news/business-news/economy/indias-fiscal-deficits-through-the-lens-of-history/)

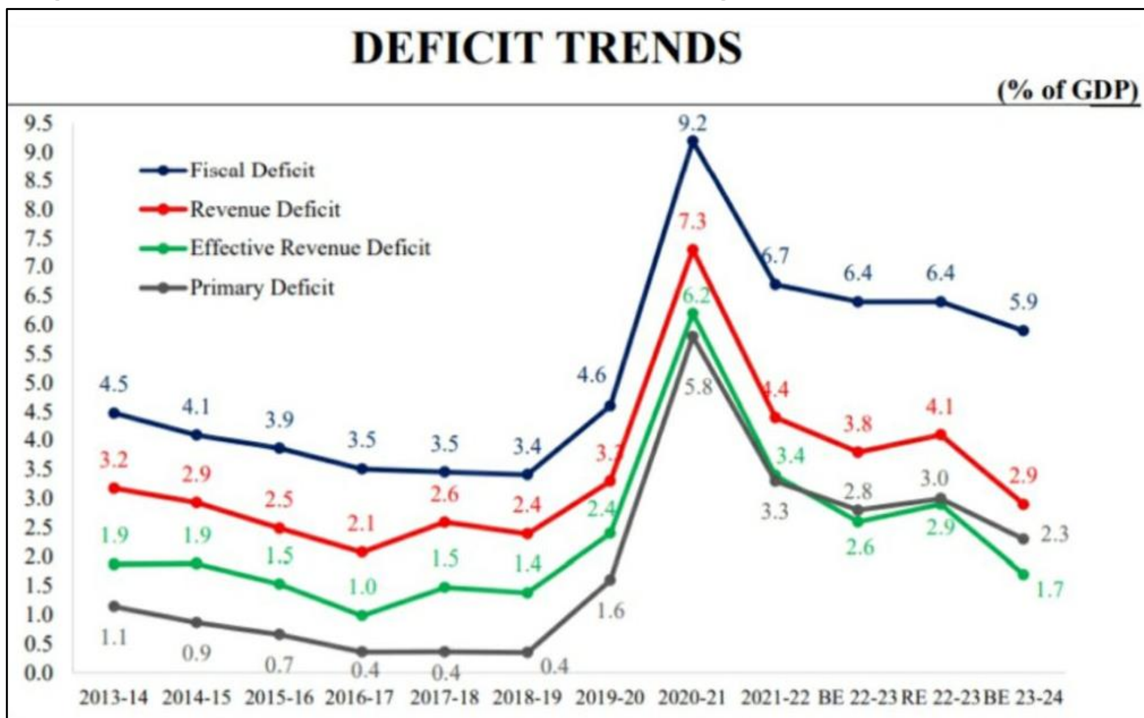
Figure 2



Recent trends

Over the past decade, India has experienced variations in its fiscal deficit-GDP ratio. Despite attempts to maintain fiscal discipline, external factors and domestic challenges have impacted this trajectory. The COVID-19 pandemic, in particular, presented unparalleled challenges, prompting the government to roll out economic stimulus packages. These measures, while essential for mitigating the pandemic's impact, contributed to an expansion of the fiscal deficit. Consequently, the government's fiscal deficit surged to 9.2% of GDP in FY20-21 in response to the repercussions of the COVID-19 outbreak. Nevertheless, through judicious financial policies and effective management, the government succeeded in reducing the fiscal deficit to 5.9% in the Budget estimates for FY23-24.

Figure 3: Central Government Deficits as Percentage of GDP (2014-15 to 2023-24)



(Source- https://upstox.com/news/business-news/economy/indias-fiscal-deficits-through-the-lens-of-history/

In the upcoming Union Budget 2024, Finance Minister Nirmala Sitharaman is expected to opt for a further reduction in fiscal deficit to 5.3% of India's GDP, through capital expenditure-driven growth instead of expenditure compression. Most economists believe the government will meet the FY24 commitment to reduce the fiscal deficit to 5.9%.

Conclusion

From the post-independence time to the era of economic liberalization and the challenges posed by global crises, the Indian government's fiscal deficits have mirrored the dynamics of the country's economic landscape. A nuanced understanding of these historical trends is crucial for formulating effective policies that promote sustainable economic growth while maintaining fiscal prudence.

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