

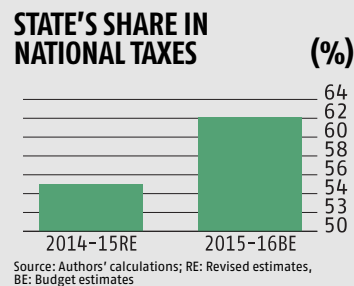
India's real fiscal policy for FY16

In the second part of a series, Syed Zubair Naqvi, Kapil Patidar and Arvind Subramanian say it seems likely the debt situation of the states will exhibit an improvement greater than that of the Centre

In the aftermath of Budget season, what is the verdict on Indian fiscal policy for the coming fiscal year (FY2016)? The finance minister's Budget speech suggested, and one of us argued ("Moving towards the fiscal target", March 1), that the answer was unambiguous on three counts. Correctly measured, India was consolidating its fiscal position; the quality of fiscal consolidation was improving; and growth-promoting capital expenditures were being enhanced. Invoking some of the same assessments, the Reserve Bank of India eased monetary policy in early March. Some private sector commentators have disagreed with this characterisation, arguing that fiscal policy was becoming expansionary.

We have since compiled new data for the states – to complement the data for the Centre – to arrive at a clearer and more accurate position of Indian public finances. And the result is to re-inforce even more strongly our three core conclusions. Consider why.

It is absolutely imperative to recognise that in the aftermath of the adoption of the recommendations of the Fourteenth Finance Commission (FFC) India's public finances must be assessed at a consolidated level by combining the finances of the Centre and the states. The reason is simple and captured in the chart "State's share in national taxes". Courtesy of the FFC, the states are expected to have and spend 62 per cent of all tax revenues collected, a jump from 55 per cent estimated for the last year



(FY2015). To focus on the Centre is, therefore, to miss more than half of all the fiscal action.

Therefore, we consolidate the fiscal estimates of the Centre and all the states for FY2015 based on the revised estimates (RE) that are likely to be closer to actual outcomes, and compare them with the Budget estimates (BE) for FY2016 recently announced by the states. We have compiled data for 17 states (which together account for more than 80 per cent of expenditure by all the states).¹

There is one technicality that we must contend with. Of the 17 states for which we have data, seven of them have presented Budgets for FY2016 without taking account of the increased transfers they will receive consequent upon the FFC.² For these states, we make plausible assumptions about how the increased transfers will be used. Specifically, we assume, partly based on the expenditure

Level of government	Fiscal deficit		Revenue deficit		Capital expenditure	
	FY15 RE	FY16 BE	FY15 RE	FY16 BE	FY15 RE	FY16 BE
States	2.8	2.5	0.0	-0.4	3.1	3.4
Centre	4.1	3.9	2.9	2.8	1.5	1.7
General	6.9	6.5	2.9	2.4	4.6	5.1
General#	7.1	7.0	-	-	-	-

General government with disinvestment receipts as a below-the-line item
Source: Authors' calculations based on Budget documents; GDP: gross domestic product

pattern of 10 states who have internalised the FFC's recommendations, that a part of the surplus resources (increased tax revenue net of reduction in plan transfers) would be used for saving and the remaining for capital expenditure in the ratio of 1/3 and 2/3, respectively

The results are presented in the table "Fiscal indicators" for our three measures of fiscal policy: the fiscal deficit (measuring aggregate consolidation); the revenue deficit (reflecting the quality of fiscal consolidation); and capital spending (reflecting the augmentation of the economy's supply potential).

Fiscal deficit: For the Centre, the deficit is budgeted to decline from 4.1 per cent of gross domestic product (GDP) in 2014-15 RE to 3.9 per cent in 2015-16 BE. For the states as a whole, the corresponding estimated change will be from 2.8 to 2.5 per cent of GDP. Combining the two, the fiscal deficit for India as a

whole will decline by nearly 0.4 percentage points of GDP. Note that even if disinvestment proceeds are treated as financing (below-the-line) items, the consolidated overall deficit will decline by 0.14 percentage points of GDP.

Revenue deficit: For the Centre, the revenue deficit for FY16 is budgeted to decline marginally. However, the states will witness a sharp increase in their revenue surplus by about 0.4 percentage points of GDP. Combining the two yields an improvement in the consolidated revenue deficit of about 0.44 percentage points of GDP. It is worth emphasising that the states on average are much more prudent (lower overall deficit) and have a better quality of fiscal adjustment (revenue surplus compared with revenue deficit) than the Centre.

Capital expenditures: At a time of weak private investment, the central government's Budget was aimed at raising public investment in order to further revive the economy and catalyse private investment. Constrained, however, by the FFC

recommendations, the Centre's public investment envelope was increased only by about ₹50,000 crore or 0.2 per cent of GDP. But it turns out that the states are going to make up for the possible shortfall of the Centre. Capital expenditures by the states are budgeted to increase by nearly 0.3 percentage point of GDP, so that the economy as a whole can expect to receive an investment boost of close to ₹1,40,000 crore or 0.5 per cent of GDP.

While updated data on public debt are not yet available, it seems likely that the debt situation of the states will exhibit an improvement even greater than that of the Centre, owing to their substantially better balance on the revenue account. So, the stock position of the Indian government will also improve.

The fear about furthering fiscal federalism (by adopting the recommendations of the FFC) was that it would undermine, or not be completely consistent with the direction of, the Centre's fiscal policy. If the Budgets recently presented by the states are any indication that fear has been allayed because on all three counts – consolidation, quality, and growth-enhancing potential – India's states have not just been consistent with the stance of the Centre, they have actually re-inforced it. On public finances, the states and the Centre appear to be partners in sync.

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Part one of the series appeared on April 10.

1. These 17 states are: Andhra Pradesh, Bihar, Chhattisgarh, Goa, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Odisha, Punjab, Rajasthan, Tamil Nadu, Telangana, Uttar Pradesh and West Bengal.

2. These seven states are: Gujarat, Jharkhand, Madhya Pradesh, Odisha, Punjab, Uttar Pradesh and West Bengal

