Chapter 2 - Fiscal Developments

INTRODUCTION

- The global economy experienced an unprecedented crisis in the year 2020. Amidst this phase of shock and uncertainty **massive fiscal measures, amounting to 12 percent of global GDP,** were taken globally to mitigate the adverse impact of the pandemic. Fiscal policy, in combination with monetary policy measures, emerged as an effective policy tool in times of crisis.
- At the domestic front, the year 2020-21 has been a challenging one on the fiscal front. The shortfall in revenue collection owing to the interruption in economic activity and the additional expenditure requirements to mitigate the fallout of the pandemic on vulnerable people, small businesses, and the economy in general, created immense pressure on the available limited fiscal resources.
- The fiscal policy response of the Government of India to the pandemic was distinct from other countries. Unlike many other countries that chose a **front-loaded grand stimulus package for revival of the economy, Government of India adopted a step-by-step approach.**

FISCAL SITUATION AND RESPONSE TO COVID-19 PANDEMIC

- **During the lockdown phase**, when uncertainty was high, the **government policy focused on ensuring that all essentials were taken care of**, which included direct benefit transfers to the vulnerable sections, emergency credit to the small businesses, and the world's largest food subsidy programme targeting 80.96 crore beneficiaries.
- **During the unlock phase**, when **uncertainty declined and the precautionary motive to save subsided,** on the one hand, and economic mobility increased, on the other hand, India ramped up its fiscal spending focusing on overall demand revival.
- With the easing of movement and health-related restrictions in the third quarter, the pace of government expenditure has picked up sharply. Second to pandemic relief, the Government has placed maximum priority on **productive domestic capital expenditure which has a high multiplier effect on the economy.**
- In order to cater to the increased demand for resources, the target **for gross market borrowings** of the Central Government for the financial year 2020-21 was revised from the Budget estimate of 7.8 lakh crore to 12 lakh crores.
- The data on Government accounts for April to November 2020, released by the Controller General of Accounts, show that the **fiscal deficit of the Central Government at end November 2020 stood at 135.1 per cent of the BE** compared to 114.8 per cent during the same period in 2019-20
- Adoption of **countercyclical expansionary fiscal policy in times of crisis is expected to boost the growth in GDP both directly**, and indirectly through multiplier effects on private consumption expenditure and private investment. Higher GDP growth would thereby facilitate buoyant revenue collection in the medium term, and thereby enable a sustainable fiscal path.

REFORMS IN TAX ADMINISTRATION

The Government has consistently adopted reform measures aimed at the long-term benefits of a more transparent, efficient and tax-payer friendly tax administration.

- A major step in this direction is the introduction of **'Honoring the Honest' platform** which was launched in August 2020 with an objective to impart greater efficiency, transparency and accountability, and to eliminate physical interface between taxpayers and tax officers. The key features of the platform are
  - Usage of technology, data analytics and Artificial Intelligence and
  - Recognizing taxpayers as partners in nation-building.

  The Platform stands **on 3 pillars of tax administration** reforms namely**, Faceless assessment, Faceless appeal, and Taxpayers' charter.**
- **Faceless Assessment Scheme 2020**

  The Faceless Assessment Scheme, 2019 (earlier called the e-assessment Scheme and renamed in August 2020) was based on the idea that **automated random allocation of cases across Income Tax teams** with dynamic jurisdiction and elimination of face-to-face contact between the income-tax authorities and the taxpayer can lead to an efficient, non-discretionary, unbiased single window system of assessment. In 2020, the scope of Faceless Assessment Scheme 2019 was broadened by bringing all the pending assessment cases across the country within the purview of the Scheme and declaring that any order passed outside the scheme shall be invalid.
- **Faceless Appeals Scheme 2020**

  Under Faceless Appeals Scheme, 2020, all Income Tax appeals will be finalised in a faceless manner under the faceless ecosystem with the exception of appeals relating to serious frauds, major tax evasion, sensitive & search matters, International tax and Black Money Act.

  The Scheme establishes a National Faceless Appeal Centre (NFApC) as the apex body for conduct of e-appeal proceedings in a centralized manner. Under the NFApC are Regional Faceless Appeal Centers (RFAC) to facilitate the e-appeal proceedings. The Appeal Units, headed by one or more Commissioner (Appeals) and are placed under the RFAC.
- **Taxpayers' Charter**

  The third pillar of Honoring the Honest platform is the introduction of taxpayers' charter. The taxpayer's charter for India comprises of commitments by the Income Tax Department and obligations of the taxpayers. It emphasizes the importance of fair, courteous and reasonable treatment to taxpayer
- **Further Measure required:**
  - **Need for an independent Ombudsman:** International experience suggests an ombudsman system is necessary for ensuring protection of taxpayer's rights. However, the institution, in India's past experience, was not effective and was abolished. A possible reason may have been inadequate independence from the tax department. Therefore, there is a need to reinvigorate the systems of grievance redressal in India. In such a case to **avoid the conflict of interest, ensure fair dealings and consequently build the trust between taxpayers and the concerned tax authority,** it is imperative that the redressal organisation has adequate teeth and is **independent of the tax department.** Such an institution would thereby make the **'Honoring the Honest' platform more successful** by ensuring accountability and trust in the tax administration system.

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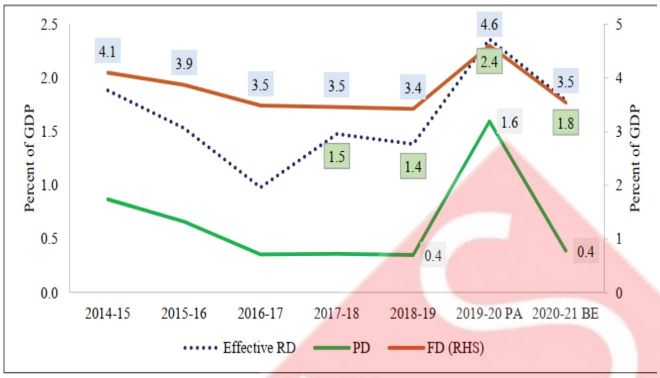
SOME IMPORTANT TRENDS

Trends in deficit: The Medium-Term Fiscal Policy (MTFP) Statement presented with Budget 2020-21 pegged the fiscal deficit target for FY 2020-21 at 3.5% of GDP, after providing adequate space for fiscal impact of the reforms adopted by the Government in FY 2019-20. The overall trend of various deficits over the past 5 years can be seen as:

Figure 9: Trends in Deficits

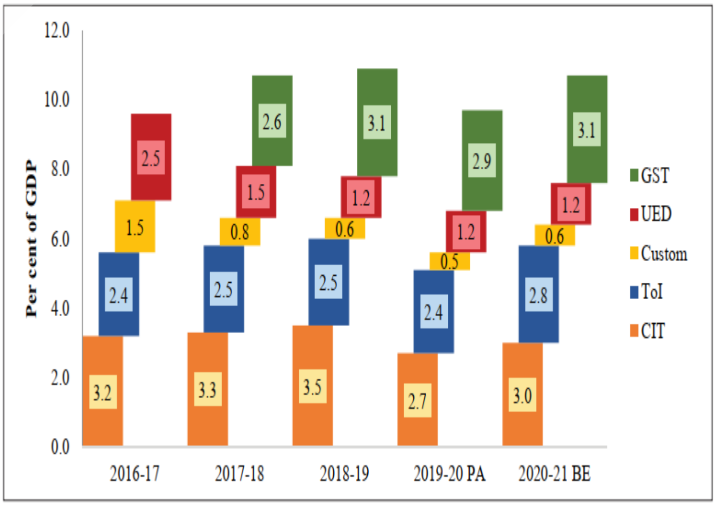


Source: Union Budget Documents & CGA
BE: Budget Estimate, PA: Provisional Actuals
FD: Fiscal Deficit; RD: Revenue Deficit; Primary Deficit

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20 PA	2020-21 BE
(in ₹ Lakh crore; Figures in parenthesis are as a per cent of GDP)							
Fiscal Deficit	5.11	5.33	5.36	5.91	6.49	9.36	7.96
	(4.1)	(3.9)	(3.5)	(3.5)	(3.4)	(4.6)	(3.5)
Revenue Deficit	3.66	3.43	3.16	4.44	4.54	6.68	6.09
	(2.9)	(2.5)	(2.1)	(2.6)	(2.4)	(3.3)	(2.7)
Primary Deficit	1.08	0.91	0.55	0.62	0.67	3.25	0.88
	(0.9)	(0.7)	(0.4)	(0.4)	(0.4)	(1.6)	(0.4)
Memo Item							
GDP at Market Price	124.68	137.72	153.62	170.95	189.71	203.40	224.89

Tax Revenues: The variation of various taxes as a percent of GDP over the years is depicted in the figure.

Figure 11: Taxes as a percent of GDP



Source: Union Budget Documents & CGA
BE: Budget Estimate, PA: Provisional Actual, CIT: Corporation Tax, ToI: Taxes on Income other than Corporation Tax (includes STT), UED: Union Excise Duties, GST : Goods and Services Tax

Central government debt: Figure below shows that total liabilities of the Central Government, as a ratio of GDP, declined steadily immediately after the enactment of the FRBM Act, 2003, and has sustained at a level during the last decade.

- Central government debt is characterised by low currency and interest rate risks. This is owing to low share of external debt in the debt portfolio and almost entire external borrowings being from official sources.
- Further, most of the public debt has been contracted at fixed interest rate making India's debt stock virtually insulated from interest rate volatility. This lends certainty and stability to budget in terms of interest payments.

Figure 14: Trend in Centre's Debt-GDP ratio

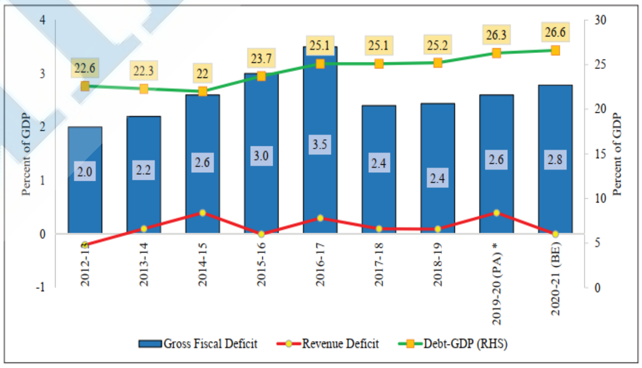
Source: Various issues of Status Paper on Government Debt; PA:Provisional

- The other salient feature is the gradual elongation of the maturity profile of the Central government's debt leading to reduced rollover risks. The proportion of dated securities maturing in less than five years has seen consistent decline in recent years.

State finances:

- The States had budgeted for a consolidated gross fiscal deficit of 2.8 per cent of GDP in 2020-21 BE.
- Figure depicts the trend of fiscal consolidation for the combined States
  in the last 3 years, with an average Gross Fiscal Deficit of 2.46 per cent of GDP. The Gross Fiscal Deficit for States is however expected to shoot up relative to the pegged Budget estimate during 2020-21.

Figure 16: Major deficit and debt indicators of States



Source: RBI State Finances: A Study of Budget; PA: Provisional Actuals ; BE: Budget Estimates
Note: States include 29 states and 2 Union Territories with legislatures.

STEPS TAKEN BY CENTRAL GOVERNMENT TO SUPPORT STATE GOVERNMENTS

The measures are as follows:

1. Enhanced limit of borrowing for FY2020-21 under Atma Nirbhar Bharat package

Under the Atma Nirbhar Bharat package, additional borrowing limit of up to 2 percent of Gross State Domestic Product (GSDP) was allowed to the States. Of the additional 2 per cent borrowing allowed to the States, the first instalment of 0.5 per cent borrowing was untied for all the states. The second part amounting to 1 per cent of GSDP was subject to implementation of following four specific State level reforms-

a) Implementation of One Nation One Ration Card System;

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b) Ease of doing business reform;
c) Urban Local body/ utility reforms; and
d) Power Sector reforms
The final 0.5 per cent borrowing was conditional on undertaking at least 3 out of the above mentioned reforms.

2. Compensation to the States for loss in GST revenue

In order to compensate the states for the loss of GST revenue during FY 2020-21, Central Government had given the states an option to either borrow the shortfall arising out of GST implementation through issue of debt under a Special Window coordinated by the Ministry of Finance which was passed on to the States and UTs (Option 1), or raise the entire shortfall through the issue of market debt (Option 2).

3. Scheme for Special Assistance to States for Capital Expenditure

During the year 2020-21, considering the fiscal environment faced by the State Governments due to the shortfall in tax revenues arising from the COVID-19 pandemic, 'Scheme for Special Assistance to States for Capital Expenditure', has been approved wherein special assistance is being provided to the State Governments in the form of 50-year interest free loan up to an overall sum not exceeding ` 12,000 crore.

4. SDRF

The Central Government by way of a special one-time dispensation had decided to treat COVID-19 as a notified disaster for the purpose of providing assistance under SDRF. In 2020, the states' limit for spending the SDRF during FY 2020-21 was raised to 50%, in order to support them in containment measures of COVID-19 including measures for quarantine, sample collection and screening; and procurement of essential equipment/ labs for response to COVID-19.

CONCLUSION

In the wake of the global pandemic outbreak, the General Government (Centre plus States) is expected to register a fiscal slippage in FY 2020-21, on account of the shortfall in revenue and higher expenditure requirements. However, longer term sustainability depends crucially on reviving growth relative to the interest cost of Government debt.

Government may have to continue with an expansionary fiscal stance. The expenditure support along with the various key reforms introduced during the year are likely to impart the required momentum to medium-term growth. The calibrated approach adopted by India allows space for maintaining a fiscal impulse the coming year. The growth recovery would facilitate buoyant revenue collections in the medium term, and thereby enable a sustainable fiscal path.