

India's 2020 budget falls short of expectations

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India's 2020–21 federal budget was presented on 1 February against the backdrop of six successive quarters of declining growth. Continuing frictions in the financial system have clogged the channels of monetary policy. This means that fiscal policy and structural reforms now have a critical role in stimulating the [slowing economy](#)^[1] and putting it back on a high growth trajectory. But the budget falls short of expectations in both areas.



The budget suggests that the causes of the slowdown are primarily external and that the slowdown is a cyclical event that has bottomed out with green shoots now emerging.

International Monetary Fund Chief Economist [Dr Gita Gopinath stated](#)^[2] that over 80 per cent of the near term worsening global economic outlook is because of India, contradicting the view that India is an innocent bystander.

The budget's nominal GDP projection for 2020–21 is 10 per cent, higher than the 7.5 per cent estimated for 2019–20. There is no projection for real GDP growth. But since consumer price inflation is currently around 6 per cent, the real GDP growth implicit in the budget may be no higher than the 4.8 per cent estimated for 2019–20. Green shoots need to be sustained to show that this is not a dead cat bounce.

The aggregate budget numbers give little indication of fiscal stimulus. This could be either because the government believes that the economy has turned around, or because it feels that there is no fiscal space given the targets mandated by the Fiscal Responsibility and Budget Management (FRBM) Act. The fiscal deficit of 3.5 per cent is marginally higher than the 3.4 per cent that was budgeted in the previous year but significantly lower than the revised estimate of

3.8 per cent.

In the absence of expenditure compression, the deficit may eventually exceed its projection (even if off-budget liabilities were excluded) due to overestimation of tax revenues, overly optimistic disinvestment projections and its impact on the consolidated budget deficit.

The projections of 12 per cent growth in tax revenues for 2020–21 appear unrealistic considering that the growth in the previous two years was just 8.5 per cent (2018–19) and 4 per cent (2019–20) due to a broken indirect tax system and sharp reduction in corporate tax rates.

The 2019–20 federal deficit was contained at 3.8 per cent of GDP against the 3.4 per cent budget projection. This was despite the 1.5 per cent of GDP shortfall in tax revenue caused by a reduction of 0.9 per cent of GDP in the states' share of tax collections and an additional 0.3 per cent of GDP windfall from the central bank. The consequential reduction in the central fiscal deficit is likely to be countervailed by an increase in state fiscal deficits.

The budget expects to realise the equivalent of 0.9 per cent of GDP through the sale of public enterprise equity. This seems unlikely at a time of declining growth and animal spirits, and when the realisations during the last three years were just 0.6, 0.5 and 0.3 per cent.

But the fiscal deficit itself is not a robust measure of stimulus. All other things being equal, lower growth increases the cyclical budget deficit even in the absence of expenditure growth due to a contraction in tax revenue. The structural deficit remains unchanged. If the FRBM Act distinguished between the cyclical and structural components of the budget deficit by factoring in revenue shocks, Indian budgets could have found the fiscal space to increase expenditure and still adhere to the mandated deficit targets.

In the absence of such accounting, Indian budgets tend to be procyclical, overestimating budget deficits during downturns and underestimating them when growth is above potential. The best measure of fiscal stimulus is expenditure growth. Overall expenditure growth is just 12.6 per cent, marginally higher than nominal GDP growth but much lower than the 19.7 per cent growth in 2019–20.

Still, the budget has a strategy for reviving growth even though it does not contain fiscal stimulus when seen in aggregate numbers. It seeks to revive growth by prioritising investment over putting more income in the hands of middle-class and rural consumers. Following the earlier corporate tax cut, the budget offers further tax relief to investors — especially foreign investors. The restructured income tax rates and slabs offer little relief to middle-class consumers.

The outlays on agriculture and rural development are projected to grow by just 13.4 per cent in 2020–21, compared to 34.8 per cent in 2019–20. The outlays on IT, telecom, transport and urban development, used as a proxy for investment in physical infrastructure, are projected to grow by 28.9 per cent in 2020–21, compared to just 8.7 per cent in 2019–20.

The lack of urgency for new structural reforms in the budget is perhaps because the

government views the current downturn as cyclical and temporary. There is little urgency to address the deep-seated frictions in financial markets, the indirect tax regime, the destruction of India's informal economy, the sharp decline in household savings and the collapse of exports that have [harmed](#) ^[3] India's growth potential.

Structural problems [require](#) ^[4] structural, not simply macroeconomic, solutions. It is not the role of the budget to fix such structural problems — some of which are not even economic — but it still could have moved in this direction.

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<https://www.eastasiaforum.org/2020/02/25/indias-2020-budget-falls-short-of-expectations/>

[1] slowing economy:

<https://www.eastasiaforum.org/2020/01/23/pushing-through-indias-economic-slowdown/>

[2] Dr Gita Gopinath stated:

<https://www.indiatoday.in/business/davos-2020/story/exclusive-india-responsible-for-80-of-slashed-global-growth-estimate-imf-chief-economist-gita-gopinath-1638621-2020-01-20>

[3] harmed: <https://www.eastasiaforum.org/2019/09/18/enigmas-of-the-indian-economy/>

[4] require:

<https://www.eastasiaforum.org/2019/11/20/taking-indias-economy-beyond-us5-trillion/>