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Is India’s fiscal health blemished?

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Abstract: *Budget 2020 was more voluble than sensible according to critics -- critics of the qualified kind and critics of the armchair kind. The latter category need not justify the stand it has taken vis-à-vis the budget for obvious reasons. But the former category should, and it may not find the task difficult . In the circumstances, it is time one got down to brass tacks to ascertain which of the two categories is right in its appraisal of the budget. The researcher got down to the task by capturing the trend clocked by the government of India in the tax revenue space, net of the share of state governments during the period FY 2011-20. The tax revenue had grown at a compounded annual growth rate (CAGR) of 12.54 percent. Non-tax revenue had grown at a CAGR of just over four percent. There was scope to improve the non-tax revenue given the diversified basket of services the GoI offered. It was not advisable to tinker with the tax regime since the move would draw flak . Interest payment obligation had grown at a CAGR of 12.22 percent , almost on a par with the CAGR associated with the tax revenue, suggesting that a step forward was matched by a step backward. Not surprisingly, such a trend led to an anomalous outcome in fiscal 2019 -- an outcome where the government's capital expenditure amounted to INR 3,07,714 crores but its interest payments amounted to INR 5,82,648 crores. In certain quarters, attempts are made to downplay such anomalous outcomes, but the researcher would like to view them as a simplistic solution to a rather complex problem.*

Key Words: *anomalous; appraisal; brass tacks; CAGR; flak; scope; simplistic; tinker.*

1. INTRODUCTION:

Article 112 of the Indian Constitution defines the Union Budget or the annual financial statement, as a statement of the projected receipts and expenditure of the government for that particular year. Union Budget maintains the account of the government's finances for the fiscal year. The fiscal year commences from the first day of April and terminates on the 31st day of the following March. Union Budget can be decomposed into revenue budget and capital budget. The revenue budget embraces the government's revenue receipts and expenditure. The revenue receipts can be decomposed into two components, namely tax revenue and non-tax revenue. Revenue expenditure, on the other hand, is the expenditure incurred to run the government and the expenditure incurred by the government to provide various services to the people. Capital budget brings within its ambit, the capital receipts and payments of the government. Loans raised from the public, from foreign governments and from RBI constitute a large chunk of the government's capital receipts. Capital expenditure is the expenditure incurred to fabricate machinery and equipment, construct buildings and install health facilities, among other things. Fiscal deficit comes into the picture when the government's total expenditure exceeds its total revenue.

1.1. Statement of the problem:

For a slew of reasons, the fiscal health of the government of India remained lacklustre for a long time. In some circles, it was alleged that the country's economy was registering a “Hindu rate of growth”. The phrase referred to the low annual growth rate the country used to clock before the onset of liberalisation in 1991. In the pre-1991 phase, the GDP stagnated around 3.5 percent from the 1950s to 1980s. The per capita income growth averaged 1.3 percent. Thus the phrase was used to insinuate that India was contented with a low growth rate.

1.2. Review of literature:

- This budget has proposed to abolish the dividend distribution tax (DDT) in respect of dividends declared, distributed or paid on or after 1 April 2020 (Vikas, 2020). As a result, dividends will be subjected to tax in the hands of the shareholders at the applicable rates. However, this will benefit foreign investors/companies having subsidiary in India. They can claim credit for the tax paid on dividends in India, subject to their domestic tax law and respective treaty provisions. The budget proposes to eliminate the cascading tax effect in case of inter-corporate dividends. Hence it will permit a deduction in respect of dividends received by a

domestic company to the extent such dividend is distributed, as specified. Further, interest expenditure will be allowed as deduction from dividend income, subject to a cap of 20 percent of such income, as specified.

- The recent custom duty hikes in the budget are not protectionist since they target finished goods and not raw material (Arup & Dilasha, 2020). According to Chief Economic Advisor Krishnamurthy Subramanian, the financial year 2020-21 (FY21) targets were transparent and realistic.
- The union budget seeks to stimulate growth, simplify the current tax structure, facilitate ease of compliance and reduce litigation (Ishita & Hitesh, 2020). Towards this end, an alternative simplified tax regime has been proposed for individuals and Hindu Undivided Families or HUFs. The new personal tax regime specifies reduced tax rates spread over six income slabs. But the taxpayer availing of the new regime should be ready to forego several specified deductions/exemptions and set-off of losses. The existing higher education cess and surcharge rates continue to apply at the same rates under the new regime. The taxpayer can choose to either continue paying tax at the existing rates and avail of the benefit of deductions and exemptions; alternatively, the taxpayer can pay tax under the new regime but without claiming the specified deductions and exemptions. The choice will be available every year for taxpayers having no business income. The choice can be made at the time of filing the tax return before the applicable due date.
- Sensex registered its biggest single-day plunge in more than a decade, consequent upon the presentation of the Union Budget (India Today, 2020). The market had expected growth-boosters as well as a roadmap for fiscal discipline. The market benchmarks as a whole began to slide after the government said in the budget that it had pegged the fiscal deficit at 3.8 per cent of the gross domestic product (GDP) for the current fiscal. The target was 3.3 per cent though. The Budget abolished the dividend distribution tax on companies, shifting the tax burden to the recipients for all intents and purposes.

1.3. Research gap:

Well, what the learned researchers have said sounds convincing. As one researcher insinuates, taxing only the recipients of dividend will benefit foreign investors / companies in particular that operate in India through subsidiaries. They can claim credit for the tax they paid on the dividends they earned in India. By and large, their domestic tax laws and the double taxation avoidance agreements their governments share with the government of India, will render the task (of claiming the credit) easier. But a review of the tax revenues generated by the government and the interest outflows would have complemented their effort. It is this gap the researcher proposes to address.

1.4. Objectives of the study:

The objectives of the study are to:

1. Analyse the trend associated with revenue receipts during the period FY 2011-20
2. Gauge the implications of interest payments for the fiscal health the country's economy

Review the country's capital expenditure and total expenditure in the backdrop of the interest payments overhead

1.5. Research design:

The following paragraphs explain how the research is designed.

2. RESEARCH METHODOLOGY:

The study is descriptive in nature and uses the 'fact-finding' survey method

2.1. Sources of data:

Data required for the research has been collected from secondary sources alone.

Secondary data has been downloaded from the web sites of the Ministry of Finance of the government of India, the RBI and the financial press, among others. Since secondary data is sourced from authorised and reliable agencies / entities, the researcher is confident that it will be closest to being accurate. Inaccuracy, if any, will be too insignificant to impact the findings of the study.

2.2. Data processing and analysis plan:

Relevant statistical tools like standard deviation and CAGR have been used to analyse the data.

2.3. Limitations of the study:

Secondary data concerning FY 2019 and FY 2020 are revised estimates and budgeted estimates respectively. This may affect the accuracy of the findings of the research to a certain extent. However, given that the secondary data has been sourced from RBI, the GoI and the financial press, the accuracy of the findings may have been marred insignificantly.

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3. ANALYSIS OF DATA:

In the following paragraphs, the trend associated with revenue receipts during the period FY 2011-20 is analysed.

	Year										CAGR	
Revenue receipts	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019 (RE)**	**2020 (BE)**	**(%)**	**Std Dev**
Tax Revenue (net of States' share)	5,69,869	6,29,765	7,41,877	8,15,854	9,03,615	9,43,765	11,01,372	12,42,488	13,17,211	16,49,582	12.54	4,38,152
Non-tax revenue	2,18,602	1,21,672	1,37,355	1,98,870	1,97,858	2,51,260	2,72,831	1,92,745	2,35,704	3,13,179	4.08	84,943
Revenue expenditure	10,40,723	11,45,785	12,43,514	13,71,772	14,66,992	15,37,761	16,90,584	18,78,835	20,07,399	24,47,780	9.97	6,29,764
of which:												
Interest payments	2,34,022	2,73,150	3,13,170	3,74,254	4,02,444	4,41,659	4,80,714	5,28,952	5,82,648	6,60,471	12.22	1,83,535
Major subsidies	1,73,420	2,17,941	2,57,079	2,54,632	2,58,258	2,41,833	2,04,025	1,91,183	1,93,769	3,01,694	6.35	78,795
Revenue deficit	2,52,252	3,94,348	3,64,282	3,57,048	3,65,519	3,42,736	3,16,381	4,43,602	4,54,484	4,85,019	7.53	1,31,567
(Interest payments / Tax revenue)%	41.07	43.37	42.21	45.87	44.54	46.80	43.65	42.57	44.23	40.04		2
Capital expenditure	1,56,605	1,58,580	1,66,858	1,87,675	1,96,681	2,53,022	2,84,610	2,63,140	3,07,714	3,38,569		66,496
(Interest payments / Capital expenditure)%	149.43	172.25	187.69	199.42	204.62	174.55	168.90	201.02	189.35	195.08		276.01
Total expenditure	11,64,728	12,63,216	13,74,747	15,10,964	16,32,103	17,75,056	19,12,315	22,04,951	23,90,215			
(Interest payments / Total expenditure)%	20.09	21.62	22.78	24.77	24.66	24.88	25.14	23.99	24.38			

(Source: RBI; RE: Revised Estimates; BE: Budget Estimates; All figures in INR Crs unless otherwise mentioned)

The tax revenue of the government of India (GoI), net of the share of the state governments, grew at a CAGR of 12.54 percent during the period under review, namely, FY 2011-20. It grew from INR 5,69,869 crores in FY 2011 to INR 16,49,582 crores in FY 2020, to be more precise. The standard deviation (SD) was INR 4,38,152 crores. Thus the dispersion of the tax revenue from the average value or the mean was INR 4,38,152 crores. The following Table brings reveals the relevant information.

3.1. Non-tax revenue:

The non-tax revenue of the government of India (GoI) grew at a CAGR of 4.08 percent during the period under review. It grew from INR 2,18,602 crores in FY 2011 to INR 3,13,179 crores in FY 2020, to be more precise. The standard deviation was INR 84,943 crores. Thus the dispersion of the non-tax revenue from the average value or the mean was INR 84,943 crores. Viewed against metrics like CAGR and SD, one can infer that at least the non-tax revenue component of revenue receipts can be better exploited by GoI to raise its fiscal health. The GoI cannot attempt a similar move in the tax revenue space, since the move will hit a raw nerve. Given that a fair tax regime can trigger a virtuous circle in the country's economy, it is not advisable to tinker with the tax regime too.

A good number of sources of non-tax revenue can be tapped by the government of the day. The quantum of revenue such non-tax sources can generate varies significantly across sources. Upon scrutiny, one can anticipate that the quantum of collection of non-tax revenue from individual sources will be admittedly much less than the quantum of collection of tax revenue from individual sources. Yet, tapping the sources of non-tax revenue for raising the overall revenue collection is worth a try. The basket of non-tax revenue sources can be enlarged by adding a few items to it. Additionally, the revenue from the items already in the basket can be increased by raising the relevant service charges, rent, royalty, interest, etc , as the case may be. The government can seek solace from the fact that the move will not hit a raw nerve as it will, in the case of tax-revenue sources. For instance, the government can raise more on delivery of services like telecommunication, DTH and broadband that the consumers avail of. After all, it provides the infrastructure necessary to render the services. The government can also rationalise the interest it applies to loans and funds advanced to states for various purposes. It is time the GoI took this seriously. A CAGR of 4.08 percent in the non-tax revenue space still compares rather poorly with the CAGR of 12.54 percent in the tax revenue space and it is time the CAGR gap between the two is narrowed a bit. Put differently tax revenue is charged on income earned by an individual or an entity (direct tax) and on the value involved in transactions of goods and services (indirect tax). On the other hand, non-tax revenue is charged against services provided by the government. It also includes interest charged on loans advanced by GoI for various purposes. It should be noted that it is compulsory to pay a part of the income earned/generated and a part of the value of goods and services consumed, as tax. However, non-tax revenue comes into the picture only when services offered by the government are availed of.

3.2. Notable components of GoI's non-tax revenues:

Some notable items of non-tax revenues of GoI are interest on loans advanced by it to states and union territories. Loans could embrace non-plan activities like flood control, the state governments undertake. Loans could also embrace planned activities like the ones the public sector enterprises (PSEs), Port Trusts and other statutory bodies undertake. Dividends and profits from PSEs, transfer of surplus from RBI, petroleum exploration licence fee, power supply fee received from the Central Electricity Authority, licence fee received from telecom operators towards spectrum usage charges, licence fee received from DTH operators, commercial TV service providers and commercial FM radio service providers and fees collected for using roads and bridges are among other notable sources of non-tax revenues.

3.3. Interest payments:

The interest payments numbers are worrying. They have grown at a CAGR of 12.22 percent during the period under review, not far removed from the CAGR of 12.54 percent the tax revenue has grown by. The standard deviation or the dispersion of the interest payments from the average value or the mean was a high INR 1,83,535 crores . The interest payments to tax revenues ratio has swung between 40 percent and 46.80 percent. Such outflows of interest will curtail the resources available for developmental activities and poverty alleviation programmes.

3.4. Capital expenditure:

In FY 2019, the government's capital expenditure was INR 3,07,714 crores whereas its interest payments amounted to INR 5,82,648 crores – the latter represented 189 percent of the former, implying that the country borrowed over INR 5.83 lakh crores to meet its interest obligations. Interpreted this way, it qualifies as a debt trap, but some economists are inclined to be more charitable. They would rather sweep it under the carpet by interpreting it as a global phenomenon. Phenomenon or otherwise, facts are facts and interpreting them as a global phenomenon is at best akin to suggesting a simplistic solution to a complex problem! It represents a kind of debt trap for the country since it borrows INR 5.83 lakh crore to meet its interest payment obligations. However, some economists believe that this massive interest payment liability is not as bad as it is considered to be.

3.5. Total expenditure:

In FY 2019, the government spent 24.38 percent or almost 25 percent of its total budgeted expenditure to meet its interest payment obligations. This huge liability severely dents the government's ability to spend adequately on projects of the development kind and issues of the poverty alleviation kind.

4. CONCLUSION:

The following are the researcher's recommendations in the light of the findings arrived at:

- Government should tap the sources of non-tax revenue more effectively given that the basket of non-tax revenue sources can be enlarged by adding a few items to it. Additionally, the revenue from the items already in the basket can be increased by raising the relevant service charges, rent, royalty, interest, etc , as the case may be. The government can raise more on delivery of services like telecommunication, DTH and broadband that the consumers avail of.
- The interest payments to tax revenues ratio has swung between 40 percent and 46.80 percent. Such outflows of interest will curtail the resources available for developmental activities and poverty alleviation programmes. The government had better minimise its borrowings by lowering its budget for populistic schemes. With revenue leakage having been significantly curtailed thanks to the enforcement of the direct benefit transfer (DBT) scheme, the resultant leeway in the form of saved liquidity can be used by the government to minimise its borrowings.
- The government is entitled to a prerogative – the prerogative of arguing that the huge interest outflows from its kitty find their way back -- into the national economy, one way or the other and thus supplement the country's economic growth! But the question is why the government should spend almost a quarter of its total budgeted expenditure to meet its interest payment obligations in the first place and then contrive to retrieve the spent money. Surely it is an unwise strategy, if it can be called a strategy in the first place!

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