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Budget 2024: On the escape route

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Abstract

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Keywords: Continuity; stability; development; populism; long-term view

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Continuity was necessary for the budget, since current policy has delivered macroeconomic stability with growth, but as the first budget of a new government it was also expected to reveal policy directions required to fulfil its development agenda. The budget ably does both. There is continuity through retention of elements that have done well in the past, as well as identification of and work on the key constraints that can hold back Indian growth. It resists pressures to shift to short-term populism and retains a long-term view. Tax changes are also towards simplicity, closing loopholes and progressive but retrospective effects could be moderated. Since of the shorter time available this year and some shortfalls last year, implementation should be fast tracked.

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1. Introduction

Elements of effective budget-making derived from India's history, structure, political economy, as well as the global situation were used as a frame to assess the FY23 budget (Goyal, 2023). These included smoothing shocks and better monetary-fiscal coordination. Better quality of fiscal expenditure reduced inflation and sustained growth even as deficits and debt ratios fell. The monetary accommodation this enabled further raised growth as the multiplier was higher (Goyal and Sharma, 2018). The current budget progresses further on this escape route towards growth enabled and growth enabling fiscal consolidation. This was to be expected, given past conservative choices and the aim of evolving Indian budget-making towards a stable no shocks exercise guided by a clear macroeconomic framework and roadmap.

But there were many expectations from the first budget of a new government. There were two kinds of pressures. First, from those who think growth will sustain only if there are widespread structural reforms. Second, from those who believe private consumption is faltering and needs stimulus from the government. But evidence does not support structural flaws since the economy has sustained average growth of 8.3% for 3 years now.

While the language is couched in terms of increasing demand through equity and therefore growth, it allows multiple interest groups to jockey for benefits. But consumption sops are difficult to sustain in a country with 1.4 billion people but a narrow tax base. Past experiment with sops has had poor results. In the 1970s the one party dominance that had held after independence was lost at a time of sharp international oil price shocks. As intense multi party competition set in, populist schemes multiplied. User prices of many public services were fixed. Maintenance, investment and quality deteriorated. The rot in electricity distribution and overuse of water in farms started at this time. As competitive sops created economic distortions and stagnation the high marginal tax rates required for financing them created a large black economy. Talent fled the country.

Large income transfers in the late 2000s, as high growth and buoyant revenues encouraged Government schemes to support consumption, without improvement in food supply, only led to high inflation. This in turn raised rural wages and started a wage-price cycle. Consumer price inflation remained high well into the 2010s. The period culminated in the double deficits, slow growth and macroeconomic fragility of 2013. Since over-stimulus continued too long after the global financial crisis (GFC) it ended in over-tightening.

The pandemic also saw a crescendo of demands for all kinds of stimulus. These were justified as raising consumption and reviving the economy. But countries that followed that path saw high

inflation because of supply chain snarls etc. Emerging markets (EMs) normally face supply bottlenecks. India's balance of supply-side measures with stimulus more from better composition than level of public expenditure has served it well in sustaining a robust growth recovery with inflation within the tolerance band. But those who want more consumption transfers refuse to believe in the data, despite high frequency data being consistent with the growth estimates.

In the Indian macroeconomic structure, especially, which is hostage to frequent bouts of commodity inflation, demand stimulus is feasible to the extent supply-side bottlenecks are also being relieved. Broad food categories still dominate the consumption basket of the poor and lower middle classes eligible for transfers.

Elections over the past year saw many 'freebies' on offer. We define freebies as recurring hand-outs that do not build capacity and/or create distortions thus sustaining dependence and poverty. Although voters largely rejected them, especially in the state elections, they had some success in the national elections.

Social welfare expenditure that complements work is sustainable. Examples are creating private assets, improving public services, or subsidizing credit and job creation through revenue or capital expenditure. More high-productivity jobs are the best way to align most voters to development and they would be the most effective enforcers. Those who can look forward to participating in and benefitting from development are less likely to fall for short-term populist agendas. Therefore facilitating more jobs and complements for work should be the priority for the government.

The budget does follow this priority. It has resisted populist demands and continues with the more long-term strategy that is showing results. It has correctly identified and worked on critical bottlenecks that need to be released for India to have sustained high growth. These include raising agricultural productivity and making it climate proof, creating more infrastructure as well as good jobs, raising the level and amount of job relevant skills and working with states to improve efficiencies.

For real change to happen, it is necessary to get the private sector and states on board. The budget has used some well-designed incentives to do so. But it has also demonstrated the continuity required for stability. Smoothing shocks was a major contributor to post-pandemic policy success. Since the economy is set on a virtuous growth path it is good the budget also side-steps demands for major reform. These have the potential to shock the economy and stall growth.

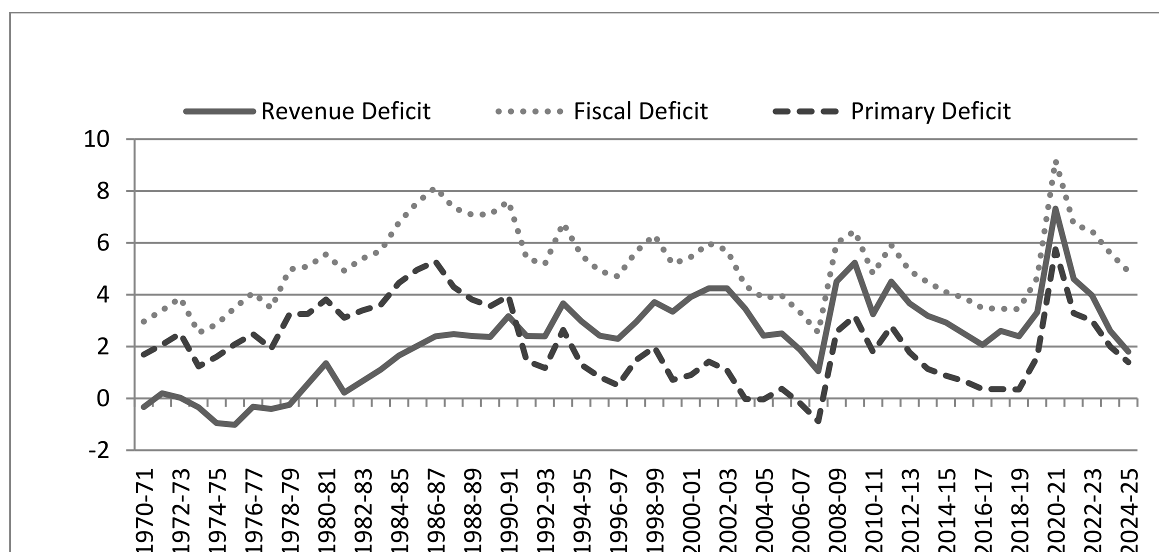
The remainder of the paper is structured as follows. Section 2 examines historical trends to show why consolidation is required. Section 3 derives lessons for budget strategy. In section 4 budget

initiatives and current expenditure patterns are analysed. The impact of major tax policy changes is also assessed. Section 5 concludes.

2. Escaping the past

Figure 1 illustrates the past the budget has to escape. The Centre's deficit ratios rose in the oil-shock ridden seventies and other external shocks interrupted past attempts to consolidate. A positive fiscal deficit (FD) meant the government borrowed to finance expenditure that exceeded tax and non-tax revenue. The revenue deficit (RD) also became positive in the early 1980s implying after that government consumption always exceeded its income or revenue. It continued to rise all through the 1990s. The primary deficit (PD), the FD minus interest payments on past borrowing, was positive most years implying fresh borrowing continually added to government debt.

Figure 1: Deficits of the central government (as a % to GDP)



Source: Calculated with data from RBI database www.rbi.org.in and from budget documents.

Government debt rises with the PD and the excess of the real interest rate (*r*) over the growth rate (*g*). Although growth was high in some periods, volatility of both g and r prevented the second effect from continuously reducing debt. Past high growth was squandered in pro-cyclical profligacy (2000s), over-stimulus (post GFC) over-tightening of macroeconomic policy (2010s) reduced the snowball effect from the *g-r* gap. Policy and real interest interest rates were too low after the GFC and too high in the 2010s for prolonged periods, contributing to growth volatility.

Table 1: Average deficit ratios

	Years	Revenue Deficit	Fiscal Deficit	Primary Deficit
NDA	2014-15: 2023-24	3.43	5.10	1.82
1st term	2014-15: 2018-19	2.50	3.67	0.52
2nd term	2019-20: 2023-24	4.36	6.52	3.13
Provisional actuals	2023-24	2.60	5.60	2.00
BE	2024-25	1.80	4.90	1.40

Source: Calculated with data from RBI database www.rbi.org.in and budget documents.

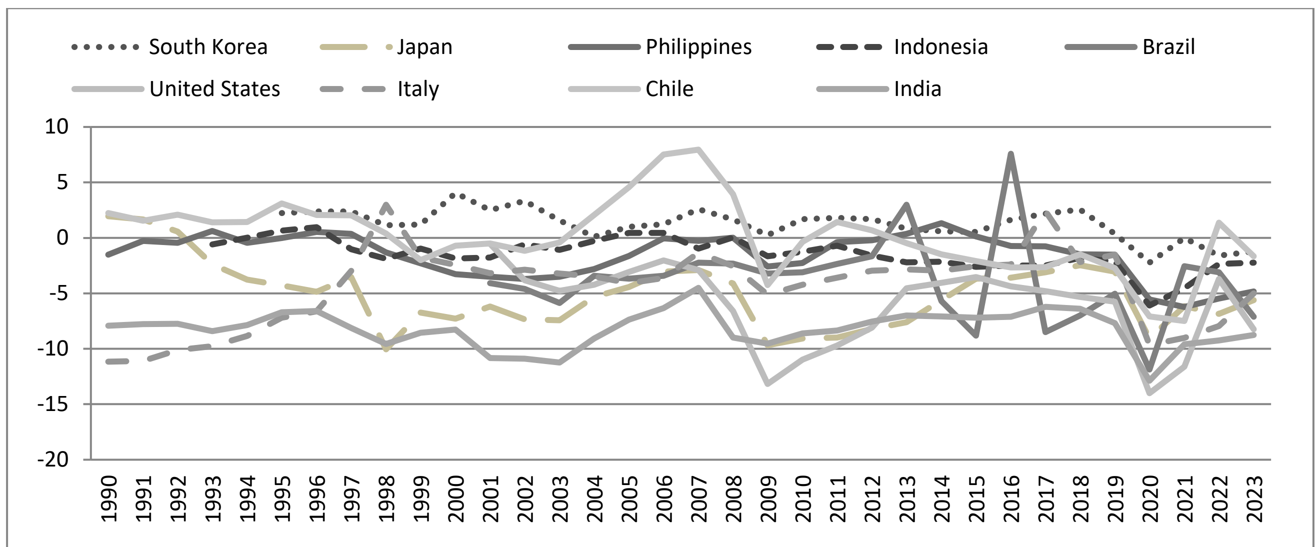
The NDA attempted to reduce deficits in its first term, but success was limited because of low growth (Table 1). In the second term deficit ratios overshot because of negative growth during the pandemic. But unlike after the GFC, when stimulus was continued too long, consolidation, aided by a robust growth recovery, began the very next year. In Figure 1 recent deficits form a peak, unlike the sustained plateaus after past shocks. In the three years 2021-24 average g was 8.3% and r about 1%. Despite continued fiscal consolidation, a better composition of government expenditure and a low r provided sufficient stimulus to successfully sustain growth. And the budget announces a continuation of this combination. Policy is now well set on the escape route.

Figure 2, which gives the fiscal balance for general government for a number of countries, shows why continuing on the escape route is important. The IMF definition used in the figure tends to increase Indian and reduce US deficits. However, including state deficits does make India one of worst performing countries[1]. The figure shows only Brazil, Italy, US and Japan had higher deficits than India in some periods. It follows fiscal consolidation is necessary for India and also constitutional limits on states borrowing need to be strictly enforced.

A falling PD and $g>r$ will contribute to reducing the Centre's debt ratio from 58.4 per cent in March 2024 to 56.8 (BE, receipts budget) next year. The general government debt/GDP ratio, which had almost touched 90% in 2020 was down to 81.6 per cent of GDP in FY24 (BE) and with continued fiscal consolidation and r kept below g, should reach pre-pandemic levels of around 75% in a few years.

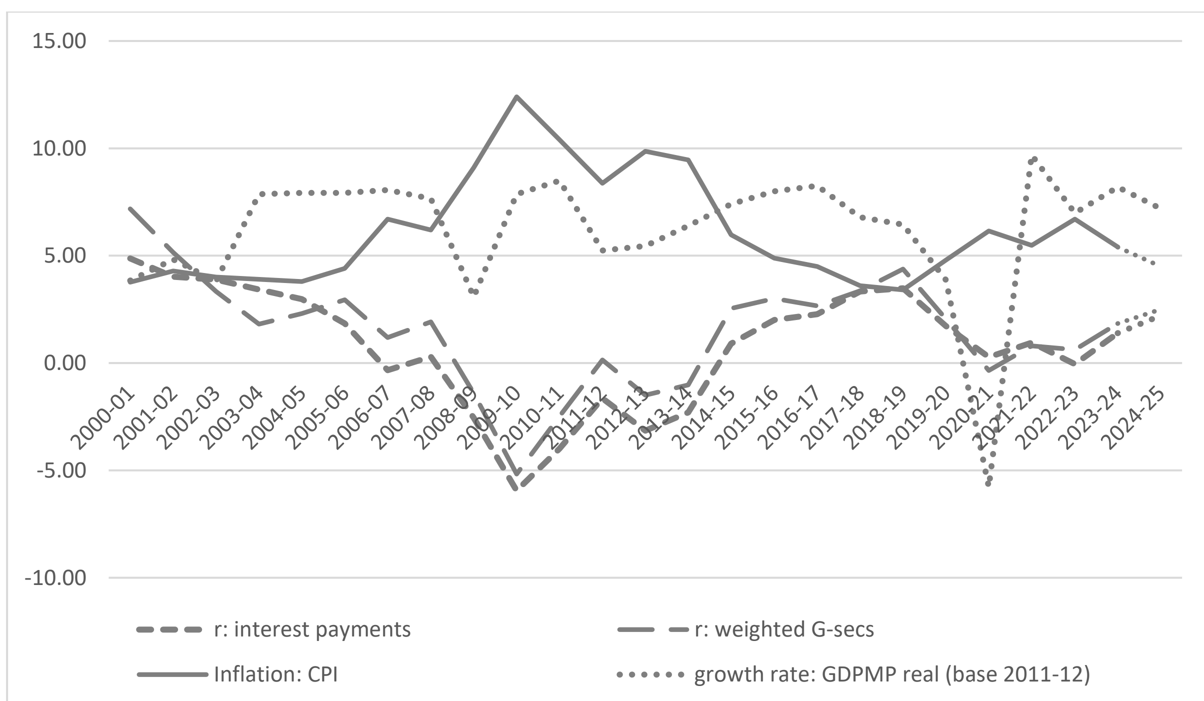
[1] According to the OECD network on fiscal relations at 28% Indian subnational debt was the 4th highest in the world in 2022. The OECD average is 20% (Dougherty, 2023; OECD, 2023).

Figure 2: Net lending/borrowing (as a % to GDP)



Source: IMF data, Fiscal Monitor (October 2023). www.imf.org
Notes: Overall fiscal balance (also headline fiscal balance) net lending and borrowing, defined as the difference between revenue and total expenditure for general government, using the IMF's 2001 *Government Finance Statistics Manual*.

Figure 3: The gap between real interest and growth rates



Source: Calculated with data from RBI database www.rbi.org.in and from MOSPI.

Note: The dotted extensions for 2024-25 are projected values.

3. Strategy

The elections suggest government priority needs to be growth that creates more productive jobs and reaches more people. For a 1.4 billion population, with the largest share of youth, this requires working on multiple fronts. The strategy for the budget follows from this. It is drawn out in this section[2] and alignment of the budget with it is examined in Section 4.

Manufacture, services, agriculture all have to grow, with a focus on labour-intensive sectors and on exports. A major reason populous China succeeded in this was that it first improved agricultural productivity sufficiently to keep food prices low. Recurrent food price shocks moderated Indian growth, while choices to subsidize both producers and consumers strained government finances and distorted resource allocation.

There are indications that agricultural productivity is finally rising with better infrastructure, adoption of agritech and some crop diversification. But much more needs to be done to improve crop choices, marketing and logistics especially since the weather is likely to be erratic in the future. Climate proofing of agriculture is necessary. Better integrated and flexible markets should be able to expand supply in response to food price shocks, through procurement from diverse geographical regions.

Above actions will raise rural jobs and incomes also, a key objective for the government, while relieving pressure to make more transfers for consumption, including to farmers.

Rising revenues today should therefore be used to carefully balance stimulating private activity with expanding capacity and making progress on fiscal consolidation, unlike in the 2000s when revenues were wasted in pro-cyclical fiscal stimuli for consumption.

Policies should be complementary to and reinforce each other. Rising revenues that go with a larger size of the economy and the shrinking number of poor make well-targeted DBT affordable. But policies should also remove obstacles in the supply of goods that will then be demanded. Targeting must be updated. As current social welfare schemes that create assets for the poor reach saturation, or needs change such as a declining share of cereals in food baskets funds released can be re-allocated towards other public services. Municipal reform including more delegation of funds and functionaries becomes urgent as urbanization increases. All this would empower the poor, who are more dependent on public services.

[2] Some of the arguments in the section were made in Goyal (2024a) a pre-budget op-ed.

In the post-pandemic period, despite fiscal consolidation, better composition of government expenditure contributed to short and long-term supply-side reforms that brought down costs and reduced inflation, allowing monetary policy to keep real rates low enough to stimulate growth yet high enough to credibly anchor inflation expectations. Such monetary-fiscal coordination needs to continue.

Along with improvements in production, the weight of food in consumption itself is falling and its components becoming more diverse, which will reduce the impact and size of future food price shocks. International oil markets are also becoming better able to absorb shocks with multiple supply sources. As a result, commodity price shocks become transient. They do not have persistent effects on inflation, especially with a more credible inflation target. This was the experience in the past few years, despite many post-pandemic shocks.

Outcomes were better also because policy was countercyclical and smoothed shocks. Indian post liberalization growth was volatile unlike the smooth Chinese double digit catch-up growth. Reasons included its sensitivity to commodity price shocks and the numerous global shocks India faced as well as domestic policy that was often pro-cyclical and magnified shocks.

But India handled poly-shocks starting with the pandemic well through a combination of countercyclical policy and structural supply-side action giving the required balance between demand and supply-side initiatives. Oil taxes were used counter-cyclically. Restrained deficit expansion and inflation-reducing action in the food and energy sectors, allowed monetary policy to support the growth recovery, while anchoring inflation expectations. Lower volatility of interest and exchange rates helped keep real interest rates smoothly below growth rates, while savers got positive real returns. This coordinated way of controlling inflation has the least cost in terms of growth sacrifice.

Shock-absorbing diversity in the economy had also increased. It had independence from the US Fed and room to align policy rates to the domestic cycle, since excess demand or tight labour markets were not driving Indian inflation; caps on interest-sensitive flows ensured outflows were only a miniscule share of reserves; large FX reserves and intervention ability reduced pass-through to inflation from exchange rate over-depreciation. It is both feasible and necessary to smooth external shocks.

Geo-politic fault lines continue, but the world has weathered two wars and rising global debt better than expected. Inflation is falling in many countries and major CBs are expected to reduce rates. Climate risk remains high.

Reducing debt and deficit ratios towards peer East Asian economies will lower country risk premiums and borrowing costs for all Indian entities. It also builds space for the counter-cyclical response required to counter possible future shocks. For successful consolidation the RD and PD must fall, while capex rises. If the general government deficit falls below 7%, India is likely to get a ratings upgrade. Already some bonds have been included in global indices.

Continuity of volatility-reducing policy is important. Steady supply-side improvements, to which the budget contributes, a stable financial sector and supportive flexible implementation of inflation targeting will build a virtuous growth momentum.

A low positive real interest allows nominal rates to rise with inflation, works to anchor inflation expectations under inflation targeting, gives savers positive returns but is also compatible with a revival of private investment. Since deficits are still positive they raise demand above supply, but much of the FD finances interest payments (3.6% of GDP), which go back to financial institutions. Its contribution to demand, therefore, rises with credit creation. Bank credit is currently growing at 15% and will in time create more deposits as it raises income.

Effective reforms would reduce costs through the economy building on India's technology and youth advantage. All tiers of government must be induced to participate in order to improve delivery in health, education, environment, courts, policing as well as in infrastructure through better coordination with and incentives for states.

Industry also has a major role in expanding skill-sets for employability, through on the job training as well as collaboration with educational institutes to fine-tune their syllabi and offer students work exposure. CSR policy can be tweaked to contribute. One firm alone tends to under-train since other firms capture part of the benefit from these activities. This is a classic spillover. So a public subsidy helps firms raise training towards the socially required amount.

Drastic reforms must be resisted since their high political costs make growth volatile. Taking advantage of India's federal structure, factor market and farm reforms are best left to competition among states with nudges from the centre.

4. Vision and implementation

The budget continues with the long-term vision of enabling India's development with strategic focus on many of the elements identified above. Transparency, past delivery, and conservative assumptions have built credibility over the past few years. First we examine if last year's

implementation record shows sustained delivery. Table 2 contrasts promises made with promises kept in the last 2 years.

Table 2: Promises made versus promises kept

	2022-23		2023-24		2024-25
	made	Kept	made	Kept	made
Revenue Deficit	-9.0	2.0	-21.7	-24.3	-31.0
Fiscal Deficit	4.4	10.3	1.8	-1.2	-7.0
FD ratio	-7.2	-7.2	-7.8	-9.8	-15.8
Primary Deficit	-7.3	4.8	-13.2	-16.6	-33.7
Interest Payments	15.6	15.6	14.8	12.2	12.8
Revenue Receipts	6.0	13.0	12.1	15.0	15.9
Tax Revenue (net to Centre)	9.6	18.2	11.7	11.4	11.9
Borrowings and Other Liabilities	4.4	10.3	1.8	-1.2	-7.0
Effective capital expenditure	27.1	25.4	28.4	20.6	18.1
Expenditure on major items					
Fertilizer	-24.9	60.7	-22.3	-16.1	-13.2
Food	-27.8	0.3	-31.3	-26.1	-3.3
Petroleum	-10.8	40.7	-75.4	33.5	-2.6
Agriculture and allied activities	-43.5	-48.4	10.4	84.2	8.1
Education	18.5	13.5	13.0	9.0	15.4
Health	0.8	-10.0	15.0	2.4	12.7
Rural Development	-0.3	17.6	-2.1	-1.8	11.2
Social Welfare	15.2	3.4	18.4	0.5	20.9
Transport	8.1	20.0	32.4	34.4	3.7
Urban Development	3.7	0.9	2.5	-7.1	19.2

Source: Calculated from the Union Budget website https://www.indiabudget.gov.in/index.php

Table 2 shows deficit ratios and revenue receipts continued their outperformance compared to targets. That the FD ratio fell more than the FD was due to higher than expected output growth. Fiscal consolidation resulted in interest payment growing less than in FY23 and less than planned, similarly for borrowings, which actually fell. Subsidies, except for petroleum that rose, fell but less than forecasted. Expenditure on transport outperformed, but effective capital expenditure growth, though still above 20%, was below planned and below last year's growth. Does this signal difficulty in raising capex further over a high base? Capital expenditure had increased from the lockdown year, itself. The level remained high at 12.7 lakh crores and is planned to increase to 15lakh crores.

The shortfalls in planned expenditure for education, health, and social welfare, rural and urban development are a concern. These are all areas where the centre has to work with states. Raising expenditure in rural development seemed to have alternated with spending in agriculture across years in Table 2. Even so, if BE for food and fertilizer subsidies are added to agriculture and rural development it comes to 16.3% of total expenditure, compared to the 31.2% share of effective capital expenditure. Comparatively, urban development gets only one third of the funds allocated for rural development. Can this be correct when there is large rural to urban migration and many rural areas are now de facto urban?

A major reason for under-performance in social sectors like education and healthcare areas is overlapping state and central responsibility. Governance issues are more of a block than finances for the improvement of many of these services. Decentralization is inadequate. With rapid urbanization well-functioning municipalities with the funds and functionaries to provide adequate services are essential. One reason states do not declare urbanizing rural areas as urban is more funds are available for rural areas. A new census is urgently required for better classification.

Funds for agriculture have to be directed more towards raising productivity, improving supply chains and climate proofing. Budget initiatives for better central/state coordination if taken up seriously, with focus on convergence towards best practices and meeting today's needs, can lead to real improvement.

Discipline and incentives imposed by independent central/constitutional institutions has worked in many instances to improve long neglected delivery of local public services. Conditionality has improved outcomes in many ways. Better performing states get more of conditional grants and they also induce better performance, helping states escape low level traps and distorting choices such as in the electricity sector or in water supply (Goyal, 2024b). In 2023 almost 90% of India's 2.55 lakh panchayats had online accounts (eGram Swaraj) (RBI, 2024) after grants to the 3rd tier were made conditional on these. Water and sanitation account for 60% of central grants and grants are a major share of panchayat finances. The interest free long term loans that are almost grants conditional on capex induced a double digit rise in states' capital spending over 2022-24. Growth in investment planned for FY24BE was 20.5% after33.8% growth in FY23RE. The budget continues these loans.

Apart from sustaining fiscal consolidation, continuing growth in capex, inducing change in states, key initiatives in the budget that are in line with the strategy outlined in Section 3 include steps to increase job creation, with incentives for firms and more focus on labour intensive sectors. The scheme to involve the private sector in skilling and allow use of CSR funds for this will improve

employability and ensure skills are relevant. The government must ensure benefits go only to expansion of existing training programs or to new ones.

Central credit warranty for MSMEs worked well during the pandemic. Since many MSMEs recovered, the funds actually needed were less, making it an efficient scheme. It is good it is being revived. Focus on ease of doing business; reducing tax/regulatory complexity, improving logistics will continue to boost activity. Policy stability is important for the private sector.

Tweaking incentives as well as the intensive use of technology to achieve outcomes continues as does movement towards an ideal of low taxes on a large base. Lowering direct tax under the no exemption regime will increase the tax base as well as provide some consumption stimulus. The budget increases progressivity marginally without distorting incentives.

It is good suggestions to impose a wealth tax were not accepted. The income tax surcharge was an efficient replacement of the wealth tax, since it is much easier to collect and evasion possibilities are less. In FY17 it was already collecting double of the last year of the wealth tax collection (Rs1029crs in FY16). BE estimate for it is Rs. 75000crs. With the surcharge the marginal income tax rate in the top bracket is 39% above that in other EMs but below some AEs listed in Table 3.

The reduction in tax for income below 12 lakhs pa will benefit 80% of payers. Average tax payer income is 13 lakhs (SBI research, 2024). The Indian middle class earning between 5-31 lakhs pa is estimated at 43.2crs in 2021 from NSS data (Krishnan, 2024). Assuming only 25% are upper middle class earning above 12 lakhs (20% of tax payers—since 80% were below 12lakhs) gives 10.8 crores as potential taxpayers in the high income brackets. But 9.37 crores paid tax (6.7% of population) in assessment year FY23 (Tandon, 2024) implying tax payers with income above 12 lakhs were only 1.87crs (1.34% of population). This is much lower than the estimate of 10.8 crores, suggesting there may be much scope yet to increase the tax base.

Table 3: Tax rates across countries in 2024

Countries	Personal Income Tax Rate (PIT)	Corporate Income Tax (CIT)
Australia	45%	30%
Indonesia	35%	22%
Malaysia	30%	24%S
Poland	32%	19%
S. Korea	45%	24%
USA	37%	21%
UK	45%	25%
Vietnam	35%	20%

Source: https://taxsummaries.pwc.com/quick-charts/corporate-income-tax-cit-rates

It is also time to assess the impact of the lower corporate tax rate (CIT) of 22% (plus surcharge of 10% and applicable health and education cess of 4%) given from tax year FY20 to existing domestic companies. For new companies it was 15%, but they had to give up all incentives and exemptions. The rate has been reduced from 40% to 35% for foreign companies in this budget.

The 58% of corporates who opted for the new tax regime lowered their tax rate to 23.26% in FY22 compared to 29.46 in FY18 (Tandon, 2024). Indian CIT rates are now comparable to its peers (Table 3), although many countries have lower rates. CIT growth was negative for the two years 2019-21, but had overtaken its FY2019 value in FY22, growing by 7.3%. Its growth had been uneven but averaged 12.8% in the 3 years to FY25. Its ten year output elasticity however, was only 0.8 compared to 2 for income tax[3]. It exceeded income tax at the start of the period but was below it at the end of the period. It is important therefore to remove exemptions that corporates can still avail—one such is capital gains—40% of capital gains tax in the assessment year FY23 came from corporates.

The capital gains tax changes are in the right direction of more uniformity and simplicity to reduce arbitrage across assets and loopholes for rich, thus increasing the tax they pay. The 1.25 lakhs exemption for capital gains protects the small investor.

But it is better to avoid retrospective changes and apply them to future asset purchases, especially for personal income tax payers who have not received a major tax cut, unlike corporates. The relaxation given to property owners in choice of the best regime can be made into an exit option for 5 years after which the new regime would apply. It would then bring idle housing stock into the market, as well as reduce the black money and tax avoidance tied with older property.

In FY24 the tax GDP ratio had risen to 0.12 from 0.10 ten years ago. It was distributed as 4% from income tax, 3% each from corporation tax and GST and 1% each from customs and central excise duty. Although the tax/GDP ratio (11.7% provisional actuals compared to pre-pandemic peak of 11.2%) has not risen much, since GDP itself is now 3.7tr$, the absolute amounts available to spend are much larger than ten years ago.

Post pandemic budgets have always spent more than they had promised. But last year spending was marginally less than planned. Although the share of capital expenditure has gone up steadily from around 20% towards 30%, its share was also less than planned. There was also large under-utilization of government cash balances. Part of the spending shortfall may be due to the elections.

[3] Calculations are based on data from MOF, 2024. The elasticity of GST over FY18 to FY25 was in between at 1.5.

More attention on project readiness and expenditure timing and quality is required so that we have over- delivery again in this year although the time period is shortened.

5. Conclusion

The budget showed considerable courage in resisting demands for middle class hand-outs and aligning capital gains taxes across assets. This will help close tax loopholes. But such changes are best made retrospectively. Asset allocation made under an earlier tax regime should be given an exit period. This would reduce underutilized housing stock and black money in property. There is much scope yet to increase the tax base.

The budget also wisely resisted pressure for big ticket factor market reforms that can be disruptive. Continuity is there and was called for in the many respects that had delivered over the past 3 years. Schemes need to adapt to the changing structure of the economy. Those asking for a big consumption stimulus should reflect why an average growth of 8.3% was achieved over the last three years despite a shrinking fiscal deficit if consumption growth was inadequate. Central capex provided stimulus but was 3-4% of GDP compared to aggregate capex of above 30%. Household (that includes informal enterprises) investment was buoyant but non-financial corporations had a dominant share (44.2%). High growth presents an opportunity for fiscal consolidation and building buffers for future needs that should not be wasted.

The beginning made in incentivizing better delivery from states and making space for more dialogue needs to be carried forward vigorously, as does the collaboration with the private sector for employment and training. Implementation may be a challenge given that the budget was much later this year, giving less time to complete schemes. There were also some slippages last year.

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