IAS GS World PCS
Committed To Excellence
exclusive Editorial Simplified
10 July 2024

A BUDGET THAT DRIVES GROWTH WITH STABILITY

The Hindu
Paper - III (Economy)

The final Budget for 2024-25, to be presented on July 23, would be the first Budget of the new government. It is an opportunity for the government to provide its medium-term growth and employment perspective along with its policy priorities. Given the continued global economic slowdown, India will have to rely largely on domestic growth drivers. The short-term objective could be to ensure a minimum 7% growth, while the medium-term objective may be to sustain the real GDP growth rate in the range of 7%-7.5%. This would be facilitated by bringing down the fiscal deficit relative to GDP from the current levels to the Fiscal Responsibility and Budget Management (FRBM) consistent level of 3% in the next three to four years. The employment objective is not independent of the growth objective except for an additional emphasis on the relatively more labour-intensive sectors in the composition of output.

Investment and savings prospects

To ensure a 7% plus growth on a sustained basis, we require a real investment rate of 35%. As in the latest available data for 2023-24, the real investment rate measured as gross fixed capital formation (GFCF), as percentage of GDP, was 33.3 for 2022-23 and 33.5 for 2023-24. Although gross capital formation (GCF) is marginally higher, we need to ensure a level of GFCF at 35% or so in the medium-term to sustain a growth of 7% plus, assuming an incremental capital output ratio of five. The saving to GDP ratio in nominal and real terms were 30.2% and 32.8%, respectively, in 2022-23. Assuming these trends continue, marginal upward adjustments are required in the savings and investment rates to ensure reaching and sustaining a level of 35% of GDP for the GFCF. One point of concern is the recent fall in household sector financial savings which, as per available information for 2022-23, had fallen to 5.2% of Gross National Disposable Income. Since this provides the investible surplus in addition to inflow of foreign capital, it is critical to increase the household financial savings rate to facilitate access to investible surplus at reasonable rates for the private sector.

On the demand side, the contribution of net exports to GDP growth has remained negative or low in recent years due to subdued export prospects. It was at 0.5% points in 2022-23 and (-)2.0% points in 2023-24. Indian service exports are expected to continue to do better than goods exports, which contracted in 2023-24. Until export demand picks up and private investment gathers momentum, India will have to rely on government investment demand to provide support to growth.

Budgetary options

Compared to the interim Budget, the Centre's revenue position is expected to improve on account of both higher tax and non-tax revenues. The base number for gross tax revenues (GTR) for 2023-24 at Rs. 34.65 lakh crore, according to the Controller General of Accounts (CGA) actuals, turned out to be higher than the revised estimates (RE) of the interim Budget by a margin of Rs. 27,581 crore. We expect a nominal GDP growth for 2024-25 to be at least 11%, made up of 7% real growth and 3.8% implicit price deflator (IPD)-based inflation. The rise in the IPD-based inflation as compared to the 2023-24 level of 1.3% is on account of expected higher Wholesale Price Index (WPI) inflation which was (-)0.7% in 2023-24. With a buoyancy of 1.1 and a GTR growth of 12.1%, we expect a GTR magnitude of Rs. 38.8 lakh crore. This would translate to a net tax revenue for the Centre at Rs. 26.4 lakh crore after providing for States' share in central taxes, a shade higher than Rs. 26 lakh crore provided in the interim Budget.

Non-tax revenues are also expected to be higher, as compared to the interim Budget estimates, due mainly to the Reserve Bank of India (RBI)'s augmented dividends of Rs. 2.11 lakh crore. We expect the Centre's non-tax revenues to exceed Rs. 5 lakh crore. It may be noted that any transfer from the RBI is going to be expansionary since it will have a liquidity effect. This transfer is similar to an extension of credit by the RBI to the government without being treated as debt. Thus, it has implications for monetary policy. However, the improved revenue situation of the central government would facilitate meeting the government's fiscal consolidation target.

Assuming that the government adheres to the 5.1% fiscal deficit to GDP ratio, as announced in the interim Budget, total expenditure that can be financed amounts to Rs. 49 lakh crore after taking into account some non-debt capital receipts. This will have to be allocated between revenue and capital expenditures. With the interim Budget expenditure magnitudes, revenue expenditure growth in 2024-25 turns out to be 4.6% over the CGA actuals for 2023-24. This growth may have to be increased to accommodate higher revenue expenditures on account of increased subsidies, increased health expenditures and increased allocations for the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) to support and provide relief largely to the rural population.

Some improvement in rural incomes is expected in the current year with the expectation of it being a normal monsoon. Our estimates indicate that even if the revenue expenditure growth is enhanced to 8%, this would provide additional revenue expenditures close to Rs. 3 lakh crore over 2023-24 actuals. This would still leave fiscal space to provide for capital expenditure growth of 19.2% in 2024-25 which would be required for supporting investment demand resulting in infrastructure expansion that is consistent with the government's medium-term objectives. Some tax rationalisation measures may be undertaken as long as they do not imply any significant revenue sacrifice. Some expansion of the ongoing Production Linked Incentive (PLI) scheme, particularly if it supports employment generation, may be considered.

Commit to FRBM targets

In conclusion, the Budget needs to aim at combining growth with stability. Stability includes both price stability and fiscal stability. It is important to signal commitment to the FRBM targets in the short to medium term. If the fiscal deficit to GDP ratio is brought down to 5.1% in 2024-25, it may take another three to four years to bring it down to 3% of GDP. As the fiscal deficit to GDP ratio is reduced and nominal GDP growth is kept in the range of 11%-11.5%, the debt GDP ratio and the interest payment to revenue receipts ratio would also come down, facilitating the reduction in fiscal deficit, thereby creating a virtuous cycle.

Expected Question for Prelims

Que. Consider the following statements-

1. The first budget of the new government will be presented on 23 July.
2. The fiscal deficit announced in the interim budget 2024-25 was 5.1%.

Which of the statements given above is/are correct?

(a) Only 1 (b) Only 2

(c) Both 1 and 2 (d) Neither 1 nor 2

Answer : C

Mains Expected Question & Format

Que.: What steps do you think should be taken in the upcoming Union Budget keeping the Indian economy in mind?

Approach to answer:

- In the first part of the answer, briefly discuss the current situation of the Indian economy.
- In the second part, describe your suggestions for the upcoming Union Budget.
- Finally give a conclusion showing the way forward.

Note: - The question of the main examination given for practice is designed keeping in mind the upcoming UPSC mains examination. Therefore, to get an answer to this question, you can take the help of this source as well as other sources related to this topic.