Fiscal Policy

- It is the prime lever of economic stabilization policy by influencing **aggregate demand** in the economy to achieve higher economic growth, full employment and price stability
- Fiscal policy is the manipulation of government spending and taxation.

- Balanced (G =T)
- Expansionary (G>T)
- Contractionary (G<T)

Debates: **procyclical** v/s **countercyclical**

- Pro-cyclical

– Keeps cycle going

spending goes up (taxes go down) in booms and spending goes down (taxes go up) in recessions.

– Private sector “damage control” actions

Countercyclical

– Changes cycle’s direction

– Public sector actions

- Fiscal policy is generally **procyclical** in emerging market economies (EMEs) (Ilzetzki and Vegh, 2008), as against being **countercyclical** in advanced economies (AEs) (IMF, 2009).

- Unlike developed countries, fiscal policy in developing countries is procyclical even during (moderate) recessions; in "good times", however, fiscal policy is actually more procyclical in developed economies.

Paolo Manasse, 2006

Why is Fiscal Policy often Procyclical?

- We explain this policy failure with a political agency problem. Procyclicality is driven by voters who seek to "starve the Leviathan" to reduce political rents. Voters observe the state of the economy but not the rents appropriated by corrupt governments. When they observe a boom, voters optimally demand more

  public goods or lower taxes, and this induces a procyclical bias in fiscal policy. The empirical evidence is consistent with this explanation: procyclicality of fiscal policy is more pronounced in more corrupt democracies.

  Alberto Alesina, Filipe Campante and Guido Tabellini, 2008

- There is evidence that fiscal policy is expansionary -- a channel disregarded by the existing literature -- lending empirical support to the notion that when "it rains, it pours."
- In the first half of the 20th century, fiscal policy attributed to **Keynesian policy** - deficiency of AD can be overcome by expansionary fiscal policy - through higher govt. spending
- Great Depression 1930s
- Rebuilding the war-ravaged economies of Europe and Japan after World War II

Why is Fiscal Policy often Procyclical?

- Keynesian policy was challenged in early 1970s due to-

(i) breakdown of the Bretton Woods Agreement

(ii) OPEC oil shock of 1973, and

(iii) mounting inflationary pressure in USA

- Economists came with new classical persuasion – Discretionary fiscal policy leads to market distortions

- With rising debt and debt problems, fiscal policy lost its importance to being mere demand shock to be addressed through monetary policy (Kuttner, 2002), and monetary policy became dominant as a stabilisation policy in 1990s.

Why is Fiscal Policy often Procyclical?

- Monetary policy supplanted fiscal policy in 1990s
- Adaptation of the inflation targeting (IT) framework by many central banks and easing of inflation pressures – known as '**Great Moderation**' – provided credible evidence and intellectual support for dominance of monetary policy until the **Global Financial Crisis in 2008**.

- Despite best efforts of major central banks in reducing interest rates by adoption of quantitative easing (QE) measures, credit conditions remained tight resulting in large scale unemployment in many countries.
- Monetary policy became ineffective, and once again fiscal policy gained attention.
- However, the effectiveness of fiscal stimulus gets negated in EMEs since policy credibility in these countries is weaker than in AEs.

- **Discretionary policy**

– Legislated changes

Discretionary fiscal policy refers to changes in taxes or spending that are the result of deliberate changes in government policy. (Changes in taxes, spending, etc) in response to economic events)

- **Automatic stabilizers**

– Programs that act counter-cyclically

Automatic stabilizers are revenue and expenditure items in the budget that automatically change with the state of the economy in such a way as to stabilize GDP.

- Automatic Stabilizers are :

– Programs for unemployed

– Progressive tax system

How? C + I + G

Adding Net Taxes (*T*) and Government Purchases (*G*) to the Circular Flow of Income

When government enters the picture, the aggregate income identity gets cut into three pieces:

$$Y_d \equiv Y - T$$

$$Y_d \equiv C + S$$

$$Y - T \equiv C + S$$

$$Y \equiv C + S + T$$

$$AE = C + I + G$$

Adding Taxes to the Consumption Function

With taxes a part of the picture, the aggregate consumption function is a function of disposable, or after-tax, income.

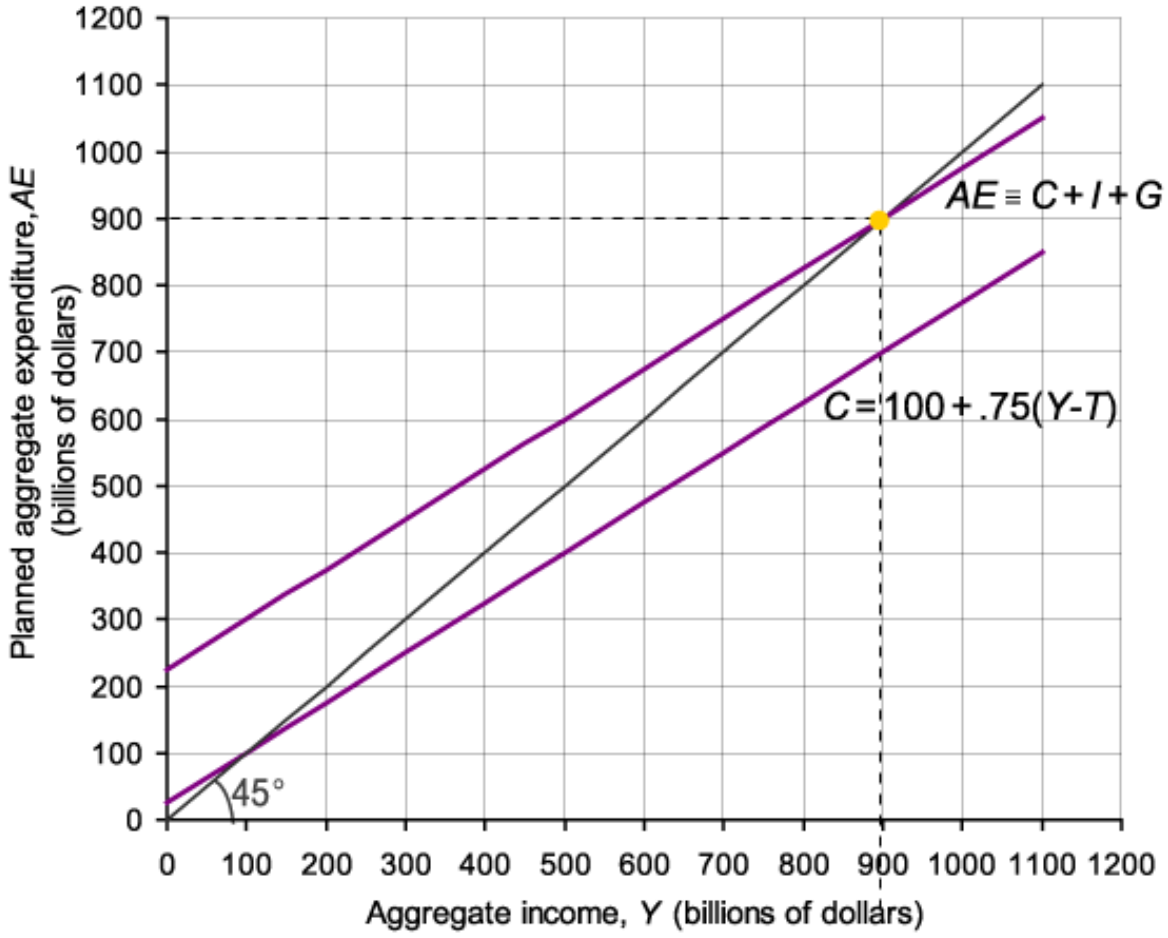
$$C = a + bY$$

$$C = a + bY_d$$

$$Y_d \equiv Y - T$$

$$C = a + b(Y - T)$$

Finding Equilibrium Output/Income



The Leakages/Injections Approach

- Taxes (*T*) are a leakage from the flow of income. Saving (*S*) is also a leakage.
- In equilibrium, aggregate output (income) (*Y*) equals planned aggregate expenditure (*AE*), and leakages (*S* + *T*) must equal planned injections (*I* + *G*). Algebraically,

$$AE \equiv C + I + G$$

$$Y \equiv C + S + T$$

$$C + S + T = C + I + G$$

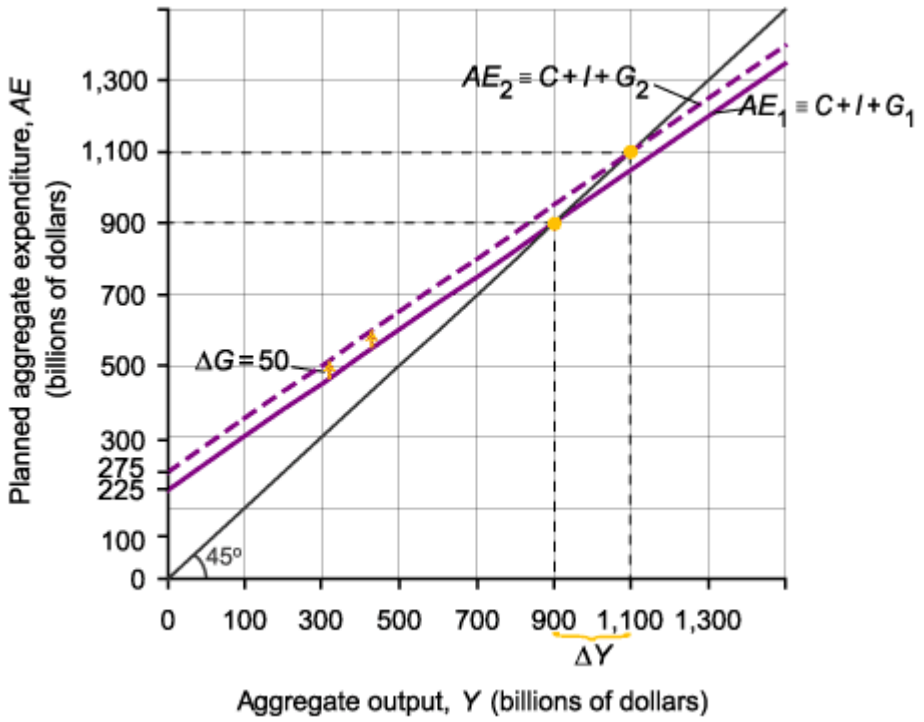
$$S + T = I + G$$

COUNTERING RECESSION

- AE increases via
  - G increase
  - C increase and/or
  - I increase
- AE change x multiplier = Equilibrium change

- G change = AE change
  - G up $100 = AE up $100
  - Assume multiplier = 4
  - $100 x 4 = $400 change in equilibrium

The Government Spending Multiplier



- If govt expenditure goes up by 1 unit, this translates to a more than one unit increase in aggregate demand

- Under **closed economy**, $Y(1-C) = I+G$

If ΔG is the increase in govt expenditure, marginal propensity to consume is c, the change in output is ΔY is k times ΔG, where is the fiscal multiplier, $k= 1/(1-c)$

- In an **open economy**, $Y=C\{Y-t(Y)\}+I+G+X-M(Y)$

Then $(\Delta Y/\Delta G)=[1/\{(c(1-t)+m\}]$=multiplier

m is the marginal propensity to import and t is the rate of tax on income

Leakages of imports reduce the power of government expenditure in an open economy

The Tax Multiplier

- A tax cut increases disposable income, which is likely to lead to added consumption spending. Income will increase by a multiple of the decrease in taxes.
- However, a tax cut has no direct impact on spending.

The Tax Multiplier

$$\Delta Y = \text{(initial increase in aggregate expenditure)} \times \left(\frac{1}{MPS}\right)$$

$$\Delta Y = (-\Delta T \times MPC) \times \left(\frac{1}{MPS}\right) = -\Delta T \times \left(\frac{MPC}{MPS}\right)$$

The tax multiplier for a change in taxes is smaller than the multiplier for a change in government spending.

$$\textit{Tax multiplier} \equiv -\left(\frac{MPC}{MPS}\right)$$

The Balanced-Budget Multiplier

The ***balanced-budget multiplier*** is the ratio of change in the equilibrium level of output to a change in government spending where the change in government spending is balanced by a change in taxes so as not to create any deficit.

Fiscal Policy Multipliers

Summary of Fiscal Multiplier

	POLICY STIMULUS	MULTIPLIER	FINAL IMPACT ON EQUILIBRIUM *Y*
Government-spending multiplier	Increase or decrease in the level of government purchases:	$\frac{1}{MPS}$	$\Delta G \cdot \frac{1}{MPS}$
Tax multiplier	Increase or decrease in the level of net taxes:	$\frac{-MPC}{MPS}$	$\Delta T \cdot \frac{-MPC}{MPS}$
Balanced-budget multiplier	Simultaneous balanced-budget increase or decrease in the level of government purchases and net taxes:	1	ΔG

The Balanced-Budget Multiplier

Balanced Budget Multiplier

- If we combine the effects of the government spending multiplier and the tax multiplier, we obtain:

Multiplier of government spending

$$\frac{\Delta Y}{\Delta G} = \frac{1}{MPS}$$

and

$$\frac{\Delta Y}{\Delta T} = \frac{-MPC}{MPS}$$

Tax multiplier

then:

$$\frac{1}{MPS} + \frac{-MPC}{MPS} = \frac{MPS}{MPS} = 1$$

- A simultaneous increase in government spending by $1 and lump-sum taxes by $1 will increase equilibrium income by $1.

The government spending and tax multipliers

Tax as a function of income

The government spending and tax multipliers:

$$Y = C + I + G$$

$$C = a + b(Y - T)$$

$$Y_d = Y - T$$

$$T = T_0 + tY$$

$$I = I_0$$

$$G = G_0$$

$$Y = a + bY - bT_0 - btY + I + G$$

$$Y - bY + btY = a - bT_0 + I + G$$

$$Y(1 - b + bt) = a - bT_0 + I + G$$

$$Y = \underbrace{\frac{1}{1 - b + bt}}_{\text{multiplier}}(a - bT_0 + I + G)$$

- The government spending and tax multipliers are derived algebraically as follows:

$$Y = C + I + G$$

$$C = a + b(Y - T)$$

$$Y_d = Y - T$$

$$T = T_0$$

$$I = I_0$$

$$G = G_0$$

$$Y = a + b(Y - T) + I + G$$

$$Y = a + bY - bT + I + G$$

$$Y - bY = a - bT + I + G$$

$$Y(1 - b) = a - bT + I + G$$

$$Y^* = \frac{1}{1 - b}(a - bT + I + G)$$

Countering Inflation

- AE decrease via
  - G decrease
  - C decrease
  - I decrease
- AE change x multiplier = Equilibrium change

COUNTERING INFLATION

- G change = AE change
  - G -$100 = AE -$100
  - Assume multiplier = 4
  - -$100 x 4 = -$400 in equilibrium

Effects of Fiscal Policy

I. An increase in Govt purchase

Effects:

- Leads to increase in demand
- C is unchanged as Y – T is not affected
- Supply remaining unchanged
- This must be met by a decrease in investment
- This requires interest to rise

Other effects:

- Because tax has not increased
- Increased govt purchase is financed by borrowing (Reducing public savings)
- With pvt savings unchanged, national savings fall
- Interest rates rise to bring about equilibrium between S and I
- Rise in interest rate may create crowding out

***II. A decrease in Taxes* Effects:**

A rise in disposable income by ΔT

C rises by ΔT X MPC

Higher MPC leads to higher C

Given production and govt purchases,

There is decrease in investment

Thus interest must rise

IS Curve

- Govt purchase multiplier
- Taxation multiplier
- Increase income
- Increase interest

Some Basic Definitions

- Revenue Receipts: Tax Revenue+ Non-tax Revenue (Direct taxes + indirect taxes + interest receipts + total profits)
- Capital Receipts: Recoveries of loans+ other capital receipts+ borrowing and other liabilities
- Revenue Expenditure: Non plan exp on revenue a/c + plan exp on revenue a/c
- Capital expenditure: Non plan exp on capital a/c + plan exp on capital a/c

Some Basic Definitions

- Plan Expenditure: Current Development and Investment Outlays (both revenue a/c and capital a/c)
- Non-plan Expenditure: Interest payments+ subsidies + defense exp (both revenue a/c and capital a/c)
- Revenue Deficit: revenue exp – revenue receipts
- Fiscal Deficit: total exp – (revenue receipts + recoveries of loan + other capital receipts)= borrowing and other liabilities
- Primary Deficit: fiscal deficit – interest payments

Fiscal Policy in India

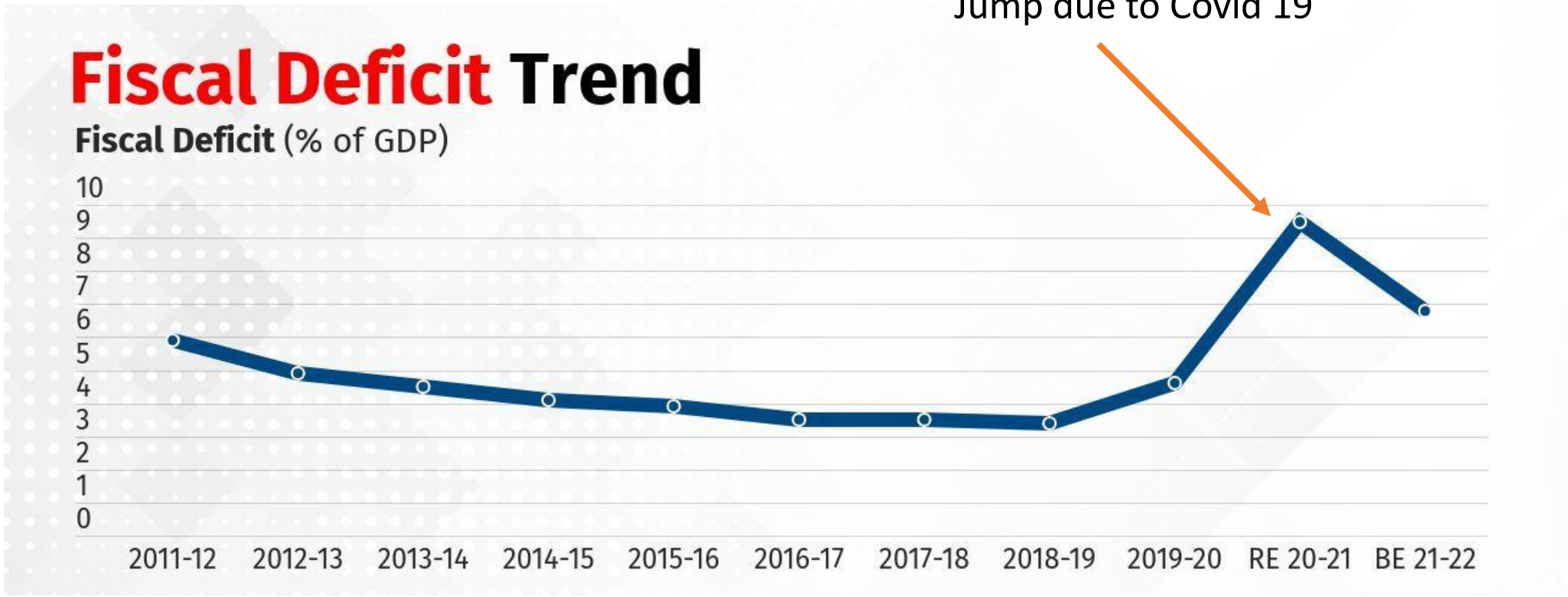
India is one of the emerging market economies which is semi-open and growing very fast. India's fiscal system has reformed significantly since early 1990s, with several ups and downs.

- 2nd half of 1980s: Govt pursued expansionary fiscal policy
  - Average fiscal deficits ran about 8% of GDP
- Gross fiscal deficit (Centre and States)
  - 1990-91: 9.1% (centre: 6.42%; states: 3.17%)
  - 2009-10: 9.43% (centre: 6.46%; states: 3.01%)
  - **2020-21: 9.2% (centre 5.27%; states: 4%)**
  - **Targeted Central fiscal deficit: 6.8%**

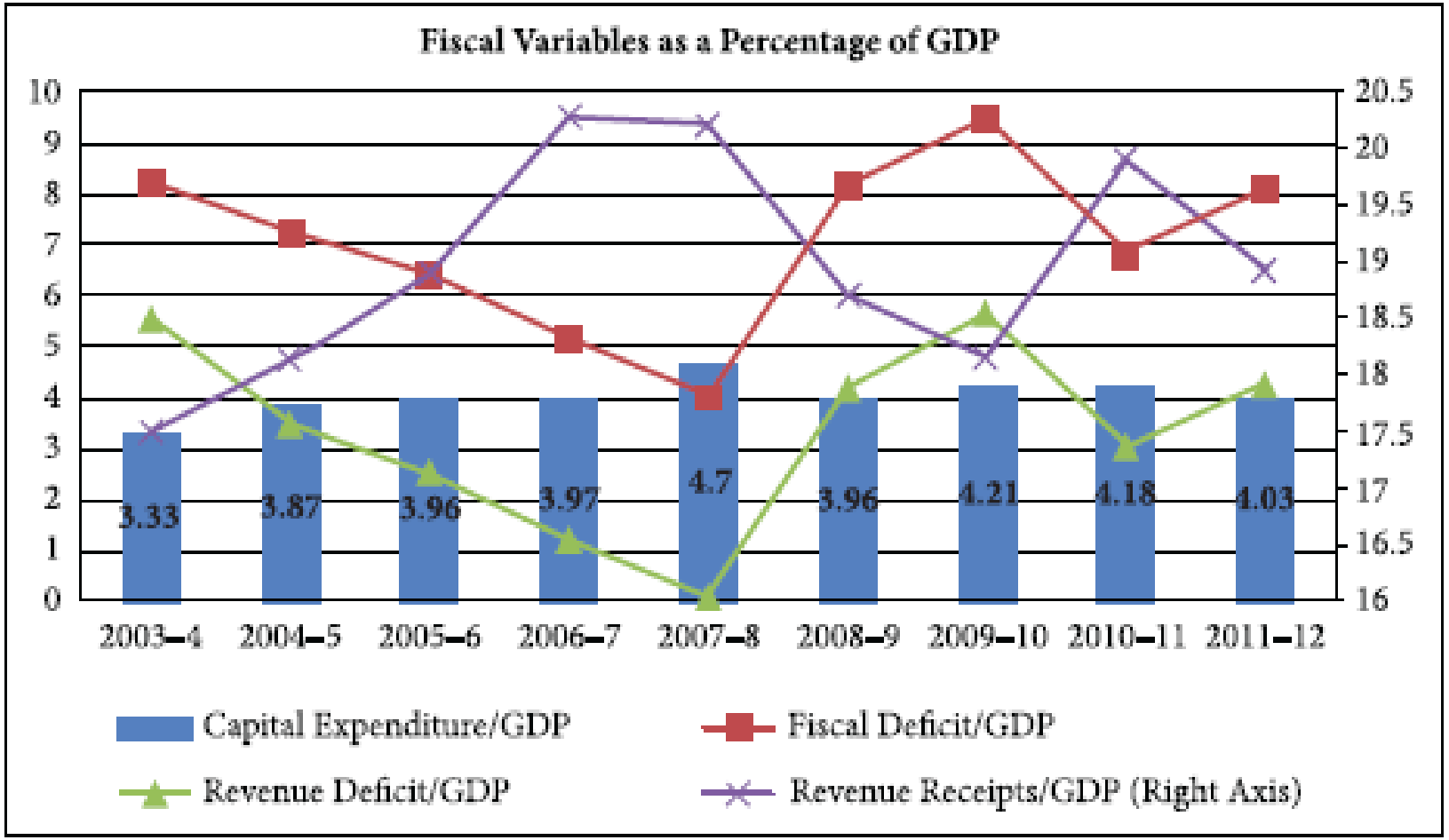
➢ Fiscal Deficit of a select comparable countries in Dec 2020:

- China: 6.5%
- Brazil: 14%
- USA: 15.2%
- Numbers are high; one of the main reasons is Covid-19.

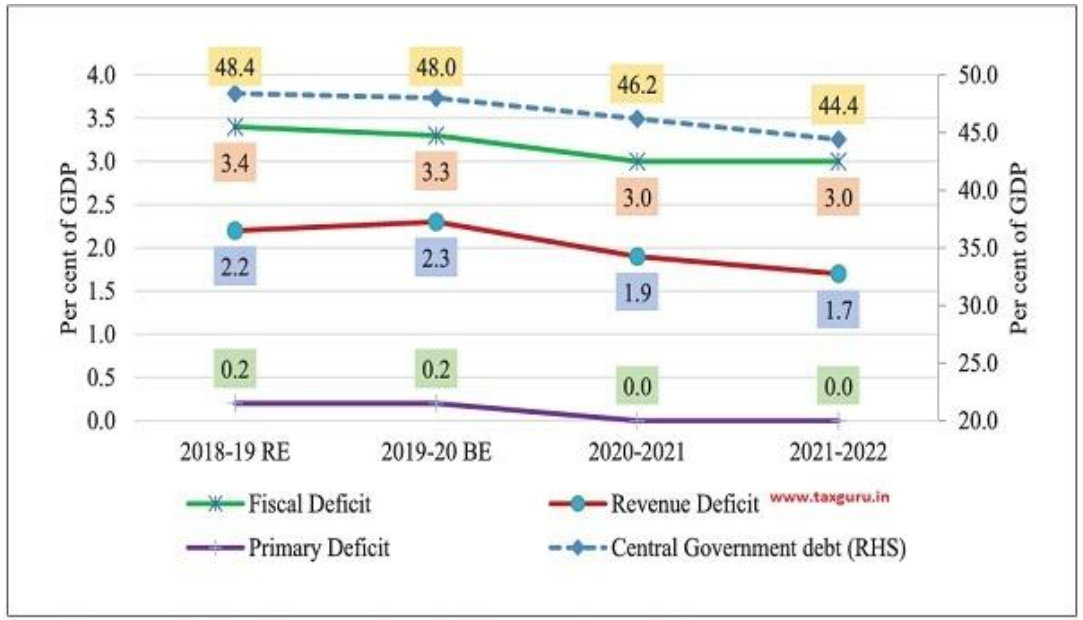
Jump due to Covid 19



The ratio of revenue receipts-to-GDP rose steadily between 2003-04 and 2007-08 and then declined- one of the reasons being tax concessions (Bose and Bhanumurthy, 2015)

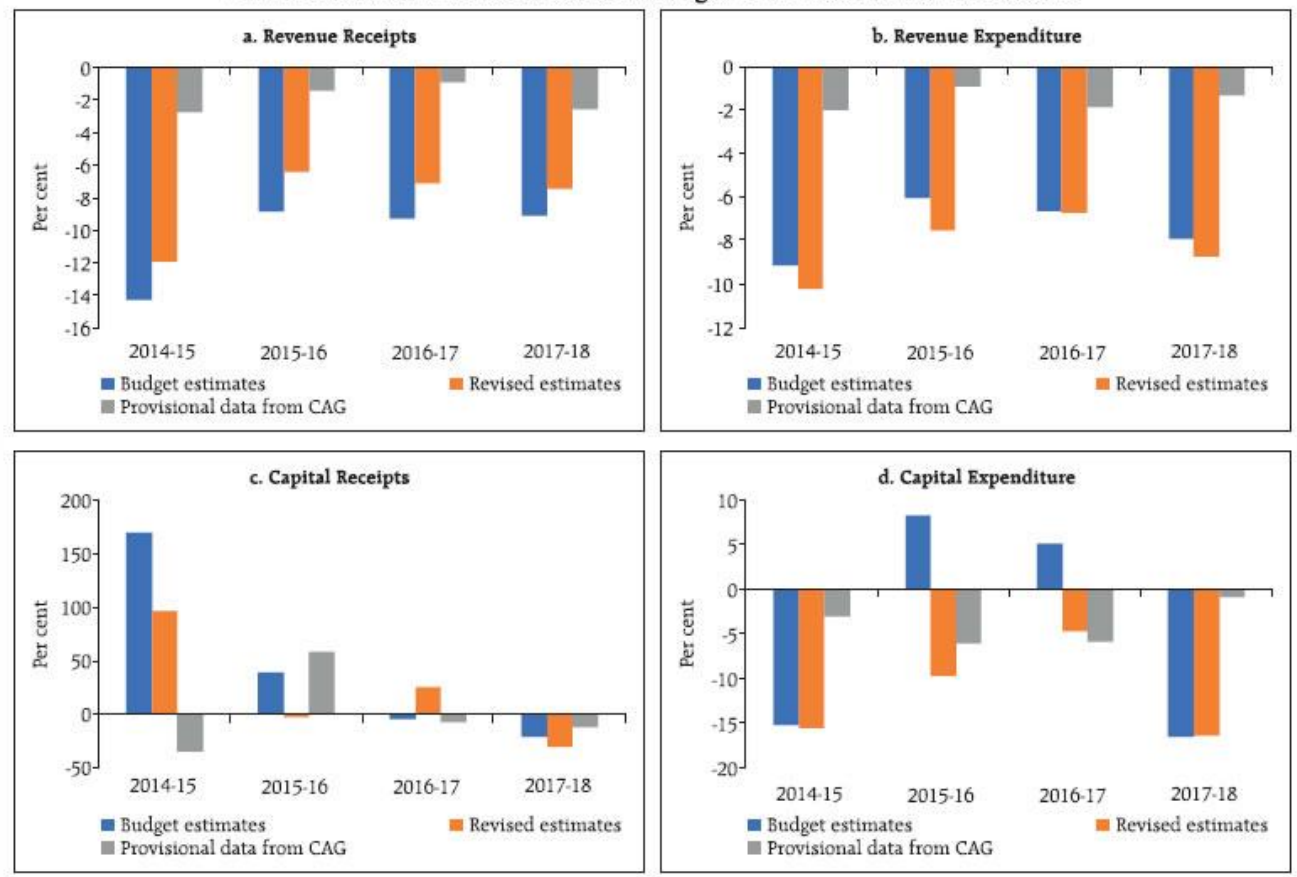


Source: *Indian Public Finance Statistics, 2011–12.*



Source: Medium Term Fiscal Policy Statement, Budget 2019-20 (July 2019)

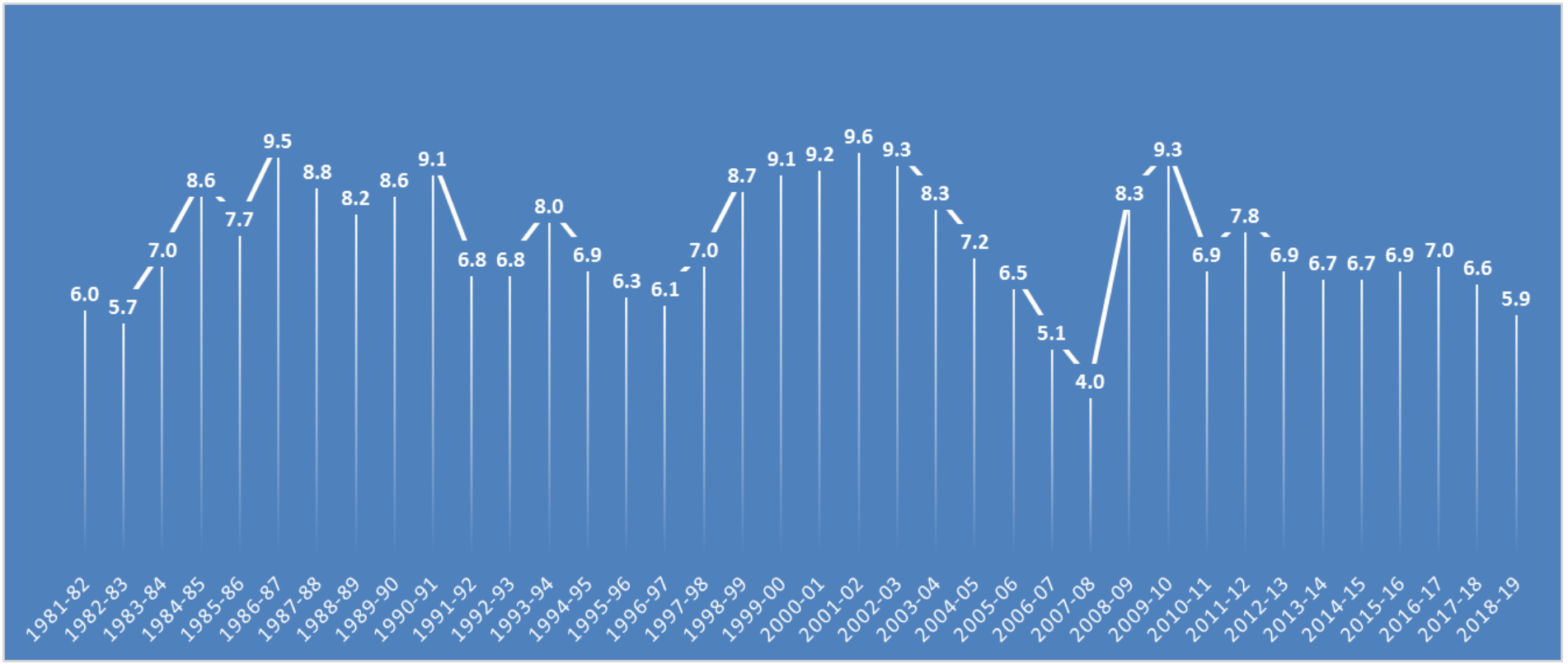
Chart 1: Deviation in States' Accounts Figures *vis-à-vis* Various Estimates



Notes: 1. Comparison is made based on aggregate data for 27 states (all states except Goa and Nagaland).
2. Capital Receipts = Recovery of Loans and Advances + Miscellaneous Capital Receipts.
3. Capital Expenditure = Capital Outlay + Loans and Advances disbursed.

Source: CAG; and e-STATES RBI Database.

Gross Fiscal Deficit (Combined Central and States)



Source: RBI, 2019

- Fiscal Deficit = Total Expenditure-(Revenue Receipts + Capital Receipts)
- 2020-21 financial year it is Rs.12.48 lakh crore (RBI, 2020)

Cont…

- Foreign exchange reserve:
  - $1.2 bl in January 1991
  - Above $582 bl in 2020
- India's general govt debt as a percentage of GDP
  - 1991: 75.33%
  - 2020-21: 76% (Central share: 66.6%)
  - **Central govt debt**: Internal: 71.6%; External:5.6%

- During 2020 general govt debt as a percentage of GDP in
  - Japan: 234.18%
  - Greece: 181.60%
  - Italy: 127.50%
  - Purtugal: 137.4%
  - USA: 82%
  - China: 61.7%
  - Indonesia: 40%

External debt

- According to World Bank (2020), India ranks nineteen in terms of absolute external debt amongst the top 20 nation after US tops the list and China at 8th.
- Among BRICS countries, in terms of indebtedness, India is at fourth position after China, Brazil and Russian Federation.

Table 4: India's Key External Debt Indicators

(Per cent, unless indicated otherwise)

End-March	External Debt (US$ billion)	Ratio of External Debt to GDP	Debt Service Ratio	Ratio of Foreign Exchange Reserves to Total Debt	Ratio of Concessional Debt to Total Debt	Ratio of Short-term Debt to Foreign Exchange Reserves	Ratio of Short-term Debt (original maturity) to Total Debt
1	2	3	4	5	6	7	8
1991	83.8	28.3	35.3	7.0	45.9	146.5	10.2
1996	93.7	26.6	26.2	23.1	44.7	23.2	5.4
2001	101.3	22.1	16.6	41.7	35.4	8.6	3.6
2006	139.1	17.1	10.1#	109.0	28.4	12.9	14.0
2007	172.4	17.7	4.7	115.6	23.0	14.1	16.3
2008	224.4	18.3	4.8	138.0	19.7	14.8	20.4
2009	224.5	20.7	4.4	112.2	18.7	17.2	19.3
2010	260.9	18.5	5.8	106.9	16.8	18.8	20.1
2011	317.9	18.6	4.4	95.9	14.9	21.3	20.4
2012	360.8	21.1	6.0	81.6	13.3	26.6	21.7
2013	409.4	22.4	5.9	71.3	11.1	33.1	23.6
2014	446.2	23.9	5.9	68.2	10.4	30.1	20.5
2015	474.7	23.8	7.6	72.0	8.8	25.0	18.0
2016	484.8	23.4	8.8	74.3	9.0	23.2	17.2
2017	471.0	19.8	8.3	78.5	9.4	23.8	18.7
2018 R	529.3	20.1	7.5	80.2	9.1	24.1	19.3
2019 PR	543.1	19.8	6.4	76.0	8.7	26.3	20.0
2020 P	558.5	20.6	6.5	85.5	8.6	22.4	19.1

R: Revised. PR: Partially Revised. P: Provisional.

Table 4.2: Outstanding Liabilities of State Governments

(At end-March, in Per cent)

Year	Amount (₹ Billion)	Annual Growth (in per cent)	Debt/ GDP (in per cent)
2012	19939.20	9.0	22.8
2013	22102.50	10.8	22.2
2014	24712.60	11.8	22.0
2015	27037.60	9.4	21.7
2016	32181.30	19.0	23.4
2017	36293.10	12.8	23.8
2018 RE	40220.80	10.8	24.0
2019 BE	45408.50	12.9	24.3

Source: State Finances: A Study of Budgets, 2017-18 & 2018-19, RBI

2019:	47867.69	13.6	25.2
2020 (RE):	53430.22	11.2	26.3
2021 (BE):	59893.60	12.5	26.6

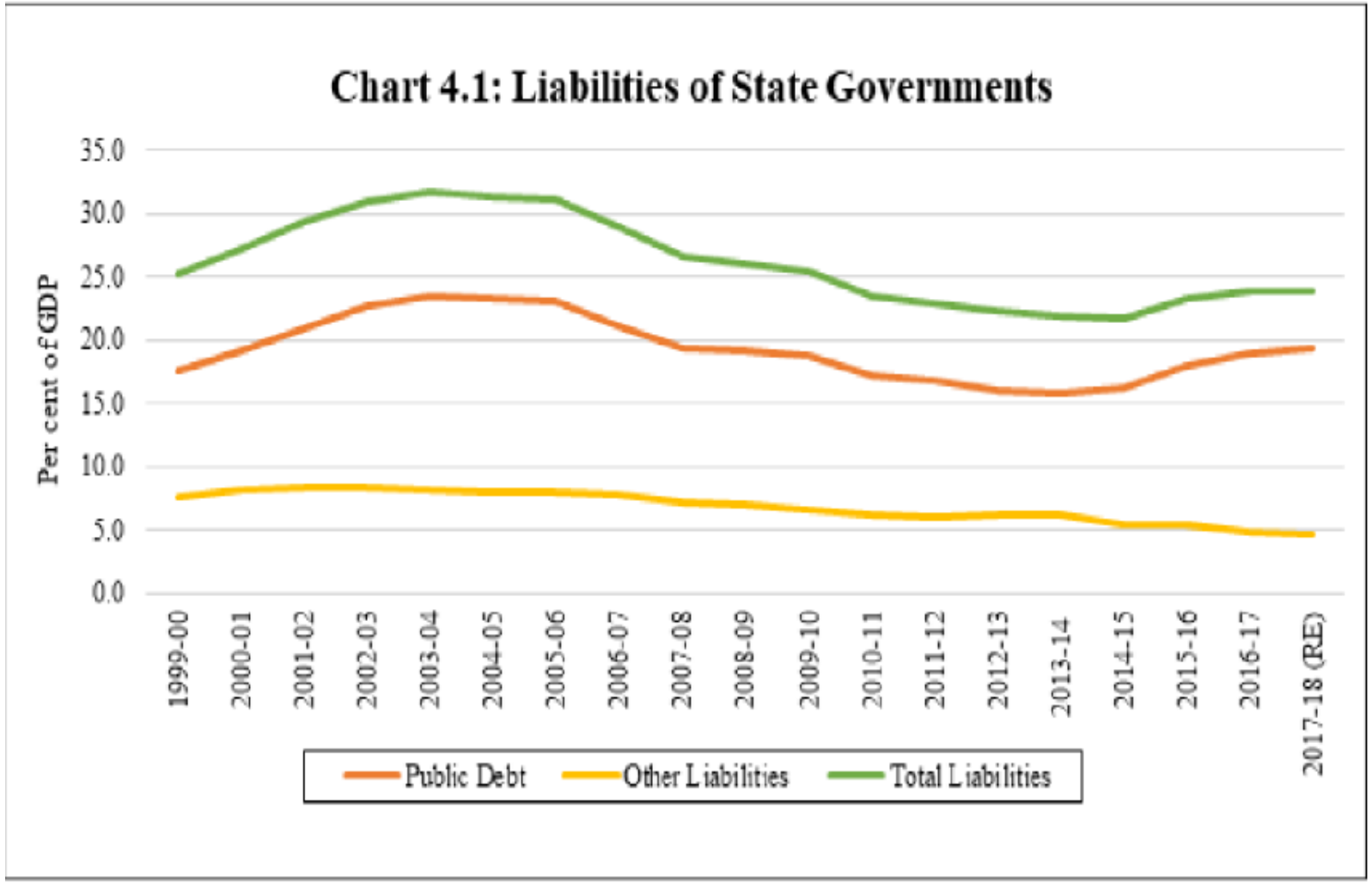


Chart 4.1: Liabilities of State Governments
Per cent of GDP
35.0
30.0
25.0
20.0
15.0
10.0
5.0
0.0
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
2017-18 (RE)
Public Debt
Other Liabilities
Total Liabilities

Chart 4.2: Trends in General Government Debt

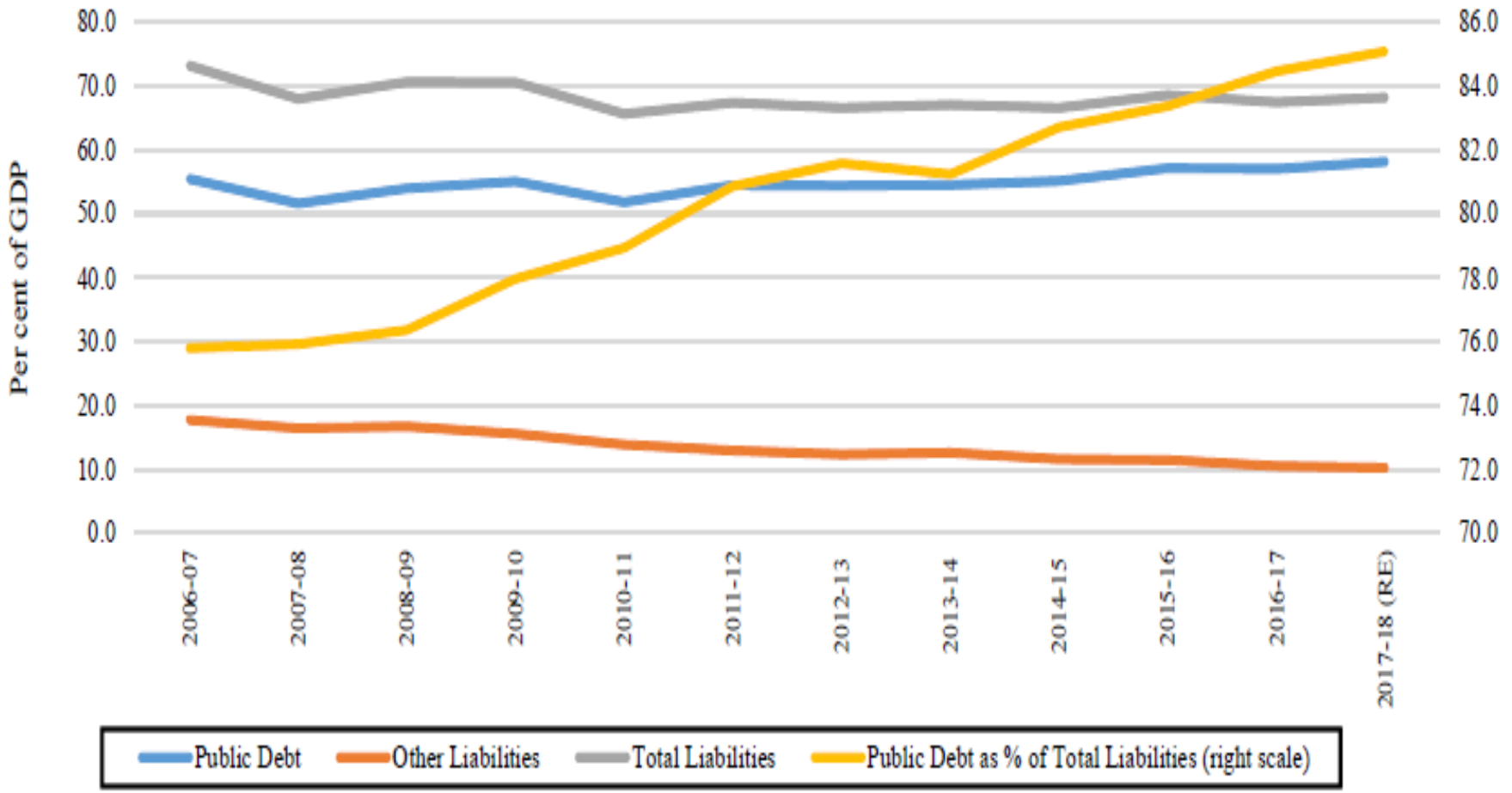


Table 5.1: Short-term Debt of the Central Government			
Year	Amount (₹ crore)	Per cent of Public Debt of Central Government	Per cent of GDP
1	2	3	4
2001-02	180649	16.2	7.7
2002-03	161378	13.3	6.4
2003-04	81987	6.2	2.9
2004-05	91720	6.5	2.8
2005-06	138454	8.9	3.7
2006-07	166270	9.8	3.9
2007-08	194964	10.6	3.9
2008-09	304253	13.8	5.4
2009-10	354117	13.7	5.5
2010-11	325683	11.1	4.2
2011-12	471559	13.3	5.4
2012-13	531318	13.0	5.3
2013-14	591629	12.8	5.3
2014-15	602801	11.8	4.8
2015-16	685819	12.0	5.0
2016-17	675044	11.0	4.4
2017-18	728976	10.6	4.3

Source : Union Budget : Various Issues.

By end June 2020 Public debt of central govt is 101.3 lakh crore.

In 2019 end June it was at 94.6 lakh crore.

Table 4.5: Maturity Profile of Outstanding State Government Securities

(At end-March, in Per cent)

Year	Up to 1 year	> 1 to 5 years	6 to 10 years	Above 10 years	Total
2007	4.8	28.2	67.1	0.0	100.0
2008	4.8	28.3	66.9	0.0	100.0
2009	4.0	25.0	70.4	0.6	100.0
2010	3.0	22.9	73.7	1.4	100.0
2011	3.6	21.7	74.6	0.0	100.0
2012	4.1	17.9	78.0	0.0	100.0
2013	3.7	19.1	77.3	0.0	100.0
2014	3.2	24.5	72.3	0.0	100.0
2015	2.8	28.6	68.5	0.0	100.0
2016	2.6	28.8	68.6	0.1	100.0
2017	3.8	28.2	64.2	3.8	100.0
2018	5.3	27.5	60.5	6.6	100.0

Source: State Finances: A Study of Budgets, RBI

2019:	5.9	26.3	62.1	3.7	100
2020:	5.8	27.2	60.2	6.8	100

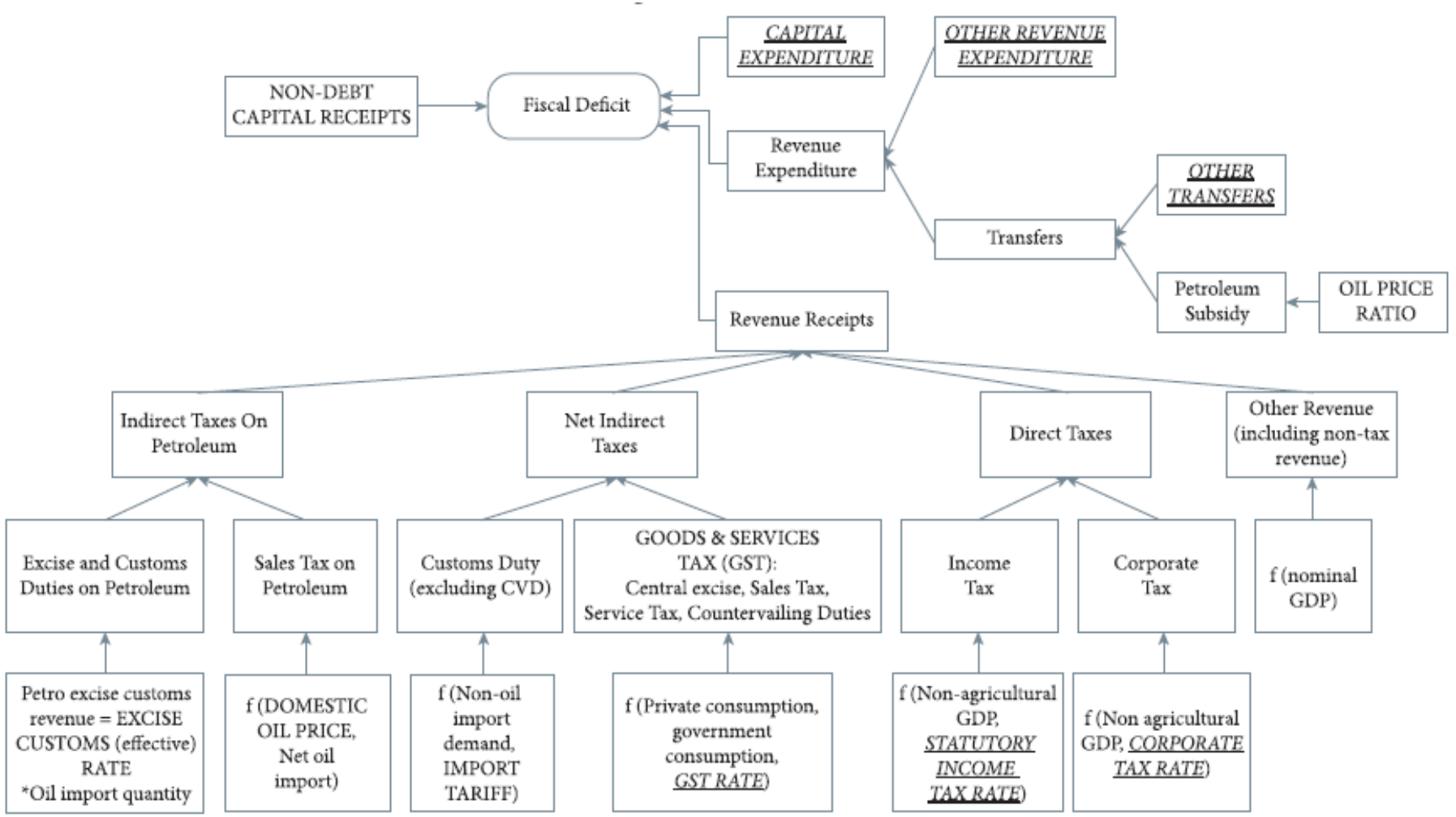
Short-term Debt of the general Government

Short-term debt of the General Government comprises short-term debt of Central Government and States after netting out inter-Governmental debt.

Tax structure in India

- Since early 1990s, India's tax system has undergone a change from highly interventionist system towards more neutrality
- Direct and Indirect tax, with latter dominating
- Direct taxes: 95% total direct taxes are collections of corporate taxes and taxes on personal income
- Indirect taxes: Consolidated under a goods and services tax (GST). The imp taxes under GST are:
- General sales tax
- Union excise duties
- Special additional duty
- customs duty
- Service tax

Fiscal revenue receipts and taxes in India



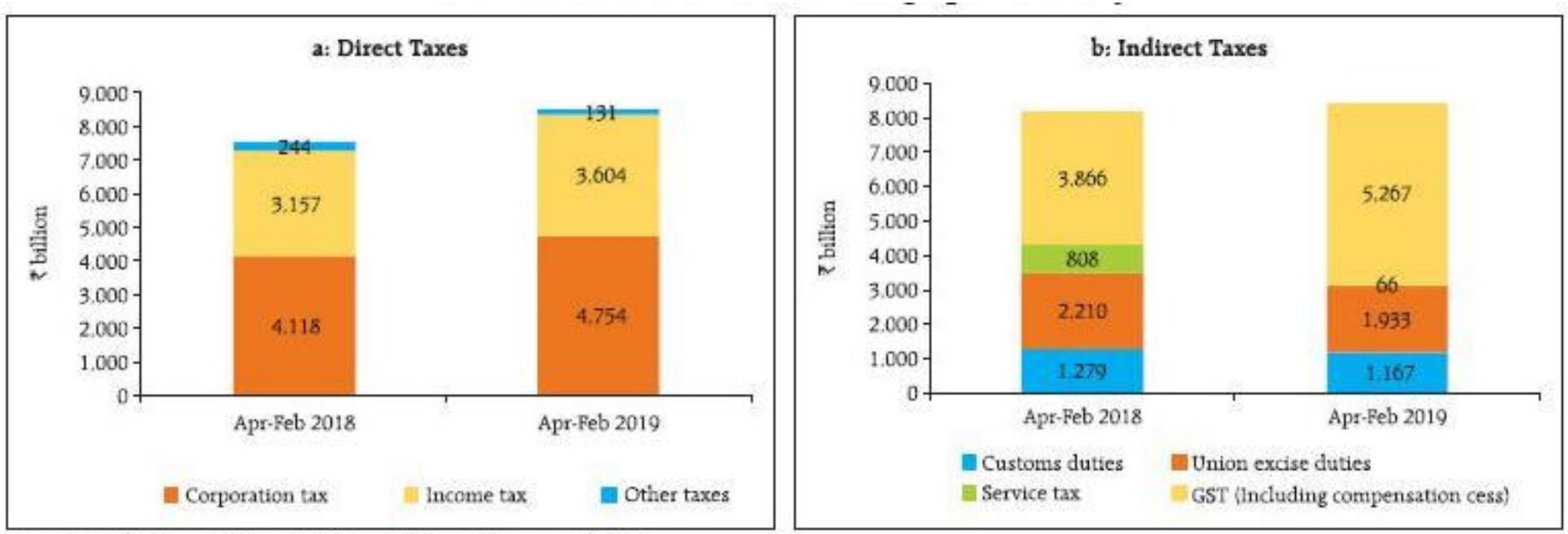
Note: Exogenous and policy-determined variables are denoted in upper case.
To obtain the multipliers, shocks are given to policy variables (indicated in italics, bold, underlined) and the impact traced through the system.

GST

- Introduced from 1 April, 2017 - The Constitution Act, 2016
- The GST is a Value added Tax (VAT) and is proposed to be a comprehensive indirect tax levied on manufacture, sale and consumption of goods as well as services at the national level
- It replaces all indirect taxes levied on goods and services
- Dual in nature- State GST and Centre GST

S. No	At The Centre	State Level
1	Central Excise Duty,	a. Subsuming of State Value Added Tax/Sales Tax,
2	Additional Excise Duty,	b. Entertainment Tax (other than the tax levied by the local bodies), Central Sales Tax (levied by the Centre and collected by the States),
3	Service Tax,	c. Octroi and Entry tax,
4	Additional Customs Duty commonly known as Countervailing Duty, and	d. Purchase Tax,
5	Special Additional Duty of Customs.	e. Luxury tax, and

Tax collection



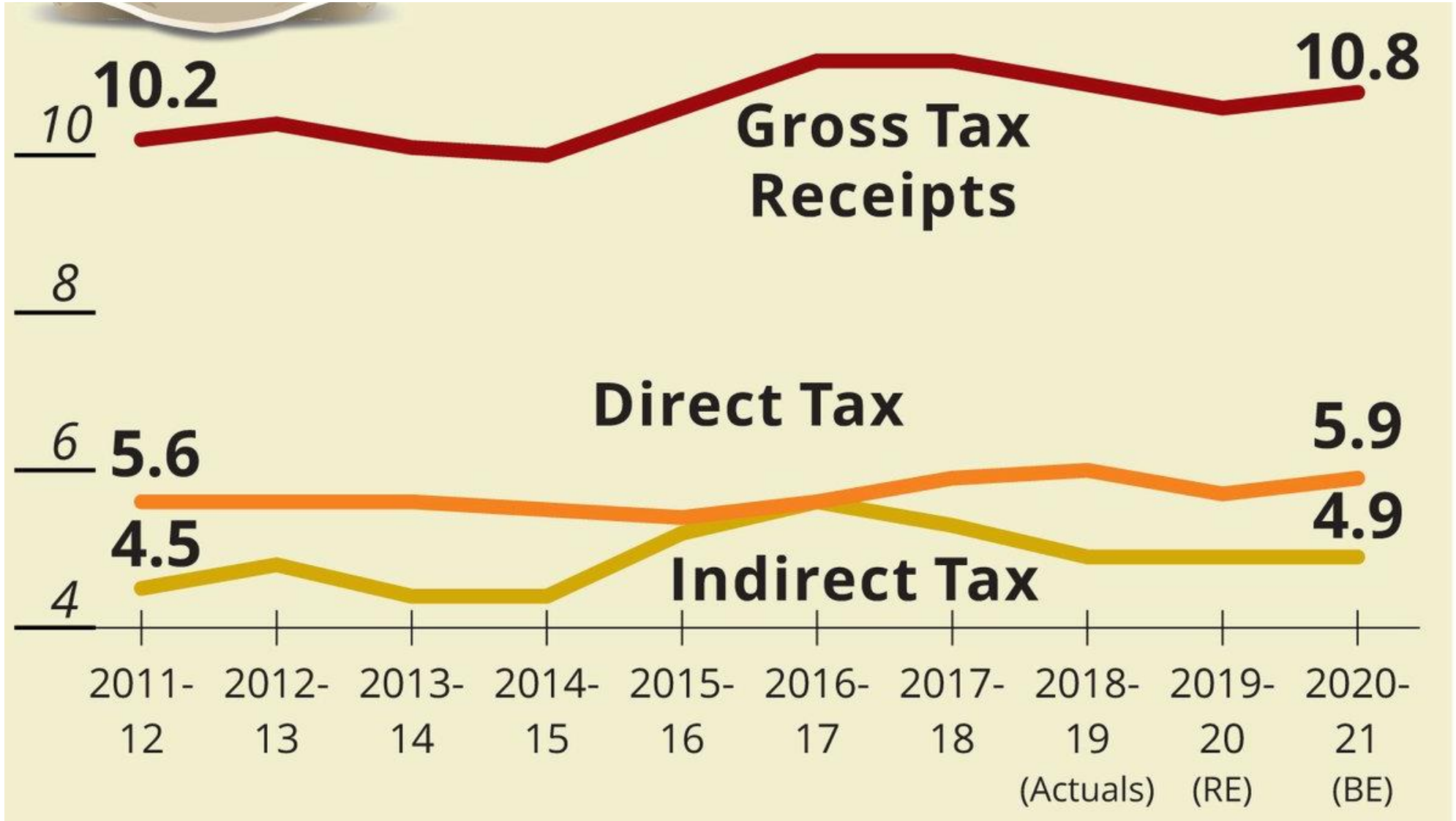
Source: Controller General of Accounts, Ministry of Finance, Government of India.

The Monetary Policy Report, 2019 states that,

- Gross tax collection fell short of the budget target in 2018-19 (Revenue Expenditure) largely due to GST collections by Rs.1 trillion.

- The Centre's fiscal deficit is 34.2% more than target at the end of Feb,2019

Tax collection in India



Tax Run Rate

	INR, Bn				YoY, %			
	F2019	F2020 RE	F2020 Apr-Dec	F2020 Jan-Mar	F2019	F2020 RE	F2020 Apr-Dec	F2020 Jan-Mar
I. Revenue Receipts	**15632**	**18501**	**11469**	**7032**	**8.9%**	**18.4%**	**5.8%**	**46.8%**
(a) Tax Revenue (net to Centre)	13170	15046	9049	5996	6.0%	14.2%	-3.4%	57.5%
-- Gross tax revenue	20802	21634	13830	7804	8.4%	4.0%	-2.9%	19.0%
Indirect Taxes + Other Tax	9550	9934	6959	2976	4.1%	4.0%	0.2%	14.4%
-- Customs	1179	1250	852	398	-8.6%	6.0%	-12.3%	90.8%
-- Excise	2310	2480	1532	948	-11.0%	7.4%	-2.0%	27.0%
-- GST	5816	6123	4435	1688	31.4%	5.3%	4.8%	6.7%
Direct taxes	11252	11700	6872	4828	12.3%	4.0%	-5.8%	22.1%
-- Corporation tax	6636	6105	3695	2410	16.2%	-8.0%	-13.6%	2.1%
-- Taxes on Income	4617	5595	3177	2418	7.2%	21.2%	5.1%	51.6%
-- Less Share of States	7615	6560	4795	1766	13.1%	-13.8%	-1.5%	-35.7%
(b) Non-tax Revenue	2462	3455	2420	1036	27.7%	40.3%	63.8%	5.1%
II. Capital Receipts (ex-borrowings)	**1029**	**816**	**310**	**506**	**-11.1%**	**-20.7%**	**-33.3%**	**-10.2%**
III. Total Expenditure	**23114**	**26986**	**21096**	**5889**	**7.9%**	**16.7%**	**15.2%**	**22.8%**
-a Capital expenditure	3030	3489	2555	934	15.1%	15.2%	20.6%	2.5%
-b Revenue expenditure	20085	23496	18541	4955	6.9%	17.0%	14.4%	27.6%
IV. Fiscal Deficit (III-I-II)	**6454**	**7668**	**9317**	**-1649**	**9.2%**	**18.8%**	**32.8%**	**-194%**

Required run rate of Tax Revenues for Jan-March to meet Revised estimates looks ambitious, given the tracking rate.

Required run rate for customs revenues seem unrealistic.

GST collection required rate looks fair given improvement in GST revenues in past 3 months.

Run rate for Direct Tax revenue seems ambitious

We expect actual Expenditure growth to be lower than implied expenditure growth as it is subject to ambitious revenue collection.

The government revised its fiscal deficit higher to 3.8% of GDP for F2020 on back of lower revenue run rate. This seems areasonable revision

Bloomberg's estimation on India's Tax collection

Source: CEIC, Budget Documents, CGA, Morgan Stanley Research
Note: RE= Revised Estimates

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Public Expenditure as % of GDP

1.9 COMBINED EXPENDITURE OF THE CENTRE AND THE STATES (REVENUE & CAPITAL)

		1990-91	2000-01	2005-06	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15 (RE)	2015-16 (BE)
6	Developmental expenditure (including loans & advances: gross)	14.32	11.59	11.96	12.88	14.15	14.17	14.18	14.47	14.22	13.45	14.59	14.00
7	Non-developmental expenditure (including loans & advances: gross)	12.14	13.87	13.32	12.06	12.83	13.84	12.87	12.79	12.40	12.74	13.10	12.90
8	Total expenditure * (2+3)	26.47	25.46	25.28	24.94	26.98	28.01	27.05	27.26	26.62	26.20	27.69	26.90
	of which:												
	i) Education, family welfare, medical & public health, and water supply & sanitation	4.24	4.19	3.89	3.76	4.13	4.48	4.51	4.53	4.50	4.42	4.55	4.53
	ii) Agriculture & allied services	2.00	1.62	1.76	1.71	2.14	1.96	1.86	1.73	1.75	1.61	2.19	2.09
	iii) Defence	2.63	2.29	2.18	1.84	2.03	2.19	1.98	1.96	1.83	1.81	1.76	1.75
9	Total expenditure net of lending	26.03	25.12	25.16	24.85	26.77	27.95	27.06	26.88	26.47	26.09	27.58	26.83

Item	1990-98	1998-2004	2004-08	2008-10	2010-14
	Average				
1	2	3	4	5	6
Expenditure on Social Services (a to k)	100.0	100.0	100.0	100.0	100.0
(a) Education, Sports, Art and Culture	51.9	52.6	47.3	44.3	46.9
(b) Medical, public Health and Family Welfare	15.7	14.2	12.9	12.0	12.3
(c) Water Supply and Sanitation	7.3	7.6	8.2	6.7	4.6
(d) Housing	2.9	2.9	2.9	3.1	2.9
(e) Urban Development	2.4	3.2	5.4	8.7	7.3
(f) Welfare of SCs, ST and OBCS	6.6	6.3	7.0	6.9	7.5
(g) Labour and Labour Welfare	1.4	1.1	1.1	1.0	1.1
(h) Social Security and Welfare	4.4	4.7	6.5	9.4	10.3
(i) Nutrition	2.2	2.2	2.5	3.1	3.3
(j) Expenditure on Natural Calamities	2.8	3.3	4.0	2.7	2.1
(k) Others	2.4	2.0	2.2	2.2	2.0
Source: State governments' budget documents.					

Expenditure on social Services over the years

Fiscal Multipliers in India

- Fiscal multipliers help to make appropriate fiscal policy decisions and choosing from among various fiscal policy instruments when there is inflationary pressures or when overall growth is faltering

Sr. No.	Variable	Peak Multiplier
1.	Revenue Expenditure (Central Government)	0.45
2.	Revenue Expenditure (State Governments)	0.82
3.	Capital Expenditure (Central Government)	3.25
4.	Capital Expenditure (State Governments)	2.00

- Estimated revenue expenditure multipliers (center and states) are less than unity (RBI, 2019)
- A value of 3.25 for the capital expenditure multiplier implies that an increase of Rs.10 million in capital expenditure by the government would raise GDP by Rs.32.5 million, by the end of the year.

Factors affecting Fiscal multipliers in India

- Greater **trade openness** is expected to have a negative impact on the fiscal multiplier as higher imports are a leakage from aggregate demand
- From the perspective of **debt sustainability**, any fiscal expansion can crowd out private demand due to absence of alternative modes of financing and endemic credit constraints
- **Capacity utilization** in the economy is an important determinant of the size of the multiplier
- The level of financial development proxied as **credit-to-GDP ratio** – determinant of multiplier's magnitude
- India has a unique characteristic of **perfect substitution** between revenue and capital expenditure. Thus, any positive shock to revenue expenditure tends to reduce capital expenditure to the extent of the shock, as well as to reduce private investment with the given fiscal deficit target and, hence, yield a negative revenue expenditure multiplier.

Govt debt externally financed:

- Relatively Small
- On concessional term

Domestic debt:

Long maturity structure

Low long term rates

Certain Major Concerns needing attention

- Quality of public expenditure (Unproductive spending)
- Capital expenditure must rise significantly (Infrastructure)
- Revenues used for servicing public debt is a concern
- Current (revenue) expenditures of the states as a % of GDP outpaces the centre’s
- Expenditure on health and education is much lower than required.
- Government borrowing is more responsive to revenue expenditure than capital outlay
- State-specific factors affecting fiscal performance play an important role in government borrowing.
- Mounting wage and pension costs (impact of pay revision)
- Populist measures (States play a significant role)
- Both tiers offset pressures by a compromise on capital expenditure

Cont….

- Agriculture outside the tax net
- Tax concession and tax holidays
- Not much is done with monetary policy
- India’s growth is below potential
- As long as output is below potential, public spending can be financed through borrowing from RBI
- Fiscal adjustment required at centre and states

Thank You