

The questions in Indian public finance

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Panel Discussion: Strategic thinking for Indian Public Finance

Panelists

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The present landscape

- ▶ S&P considers India as investment grade (BBB-)
- ▶ Conventional numbers: Union debt is 56.5% of GDP, consolidated debt is over $\approx 80\%$ of GDP for FY23
- ▶ The Indian package of high deficits and investment-grade rating rests on high GDP growth
- ▶ GDP data suffers from some mis-measurement¹

The three big questions are:

1. Is the fiscal system delivering fiscal stability?
2. Is the fiscal system conducive to the emergence of state capability?
3. What kinds of incentives is the fiscal system creating, for the people and for state actors?

¹Rajeswari Sengupta (July 2024). [The problems in India's official data](#). Big Ideas Episode 21, XKDR Forum

Is the fiscal system delivering fiscal stability?

The Union government

- ▶ Growth could falter: a good measure (immune to GDP measurement) is interest paid per revenue receipts, 36.7% FY14 A/c and 35.7% FY24 RE
- ▶ 'Financial repression': forced mobilisation of lending to the government under the guise of financial regulation. Voluntary lending is below 5%.² This is an inefficient tax, and it suggests low strategic depth for the Union government
- ▶ Law research perspective on the FRBM: failure to address fiscal stability³

Removing the financial repression system: the bond market will rein in the leviathan

²Aneesha Chitgupi Ajay Shah, Manish Singh Susan Thomas and Harsh Vardhan. (Aug. 2024). [Who lends to the Indian State](#). XKDR Forum Working Paper 34.

³Pratik Datta, Radhika Pandey, Ila Patnaik and Ajay Shah (Forthcoming). [Understanding deviations from the fiscal responsibility law in India](#). Indian Law Review.

Is the fiscal system delivering fiscal stability?

State governments

- ▶ A key insight: The design of the waterfall makes bond holders safe and public expenditures unsafe
- ▶ Case of Tamil Nadu - correct concepts of distress and default, IP/RR of $\approx 20\%$ in FY23, the state is failing to meet obligations to private suppliers, pensioners, and workers.
- ▶ Including TN electricity sector:
 1. Consolidated the off balance sheet borrowing (IP/RR - 24% FY23) and
 2. Standard debt sustainability analysis - increased debt-GDP ratio from 40% in FY23 to 44% in FY28
- ▶ Under business as usual, distress environment is reached in about five years, prioritise electricity sector reform as a part of the medium-term fiscal strategy⁴

⁴Charmi Mehta, Radhika Pandey, Renuka Sane and Ajay Shah (Feb. 2024). [The electricity chokepoint in Tamil Nadu public finance](#). XKDR Forum Working Paper 31.

Is the fiscal system conducive to the emergence of state capability?

The problem of Indian cities

- ▶ Almost all GDP growth happens in cities
- ▶ City government is a quilt of Union, state and city government
- ▶ Missing fiscal numbers for major cities, e.g. Mumbai
- ▶ Missing total government spend per capita for Mumbai vs. Bengaluru
- ▶ Lack of fiscal planning process, how to achieve situational awareness and address problems
- ▶ Fundamental fields of urban government e.g. urban public health are weak
- ▶ The fiscal system is not conducive to the emergence of state capability

Is the fiscal system conducive to the emergence of state capability?

Decentralisation is malfunctioning

- ▶ The Constitution does not correctly cut up the work of the state across Union / state / city / village governments
- ▶ 'State finance commissions' suffers from achieving desired objectives
- ▶ The Indian journey of radical decentralisation: some cities and some states will get to state capability and growth. The fiscal system hinders this

What kinds of incentives is the fiscal system creating

For state actors

- ▶ Borrowing through financial repression: The lack of checks-and-balances. Liz Truss implementation of mini-budget
- ▶ Faulty arrangements around decentralisation: people's unhappiness does not generate feedback loops into improvements of public goods
- ▶ Failure to develop a competitive environment inducing competition among cities for migrants and businesses
- ▶ Faulty GDP data going into fiscal planning: extreme pressure to obtain high tax revenues⁵

⁵Suyash Rai and Anirudh Burman (Mar 2022). [Income Tax Disputes in India](#). Carnegie India. ▶

What kinds of incentives is the fiscal system creating?

For the people

- ▶ Financial repression tax: incentive to shift to gold, real estate and overseas
- ▶ Very high tax rates: incentives to change behaviour in favour of tax avoidance and tax evasion
- ▶ Taxation of the formal sector: harms the engine of productivity growth, the large firms

What is to be done?

1. For fiscal system to deliver fiscal stability
2. For fiscal system to be conducive for the emergence of state capability
3. Kinds of incentives the fiscal system should create for the people and for state actors