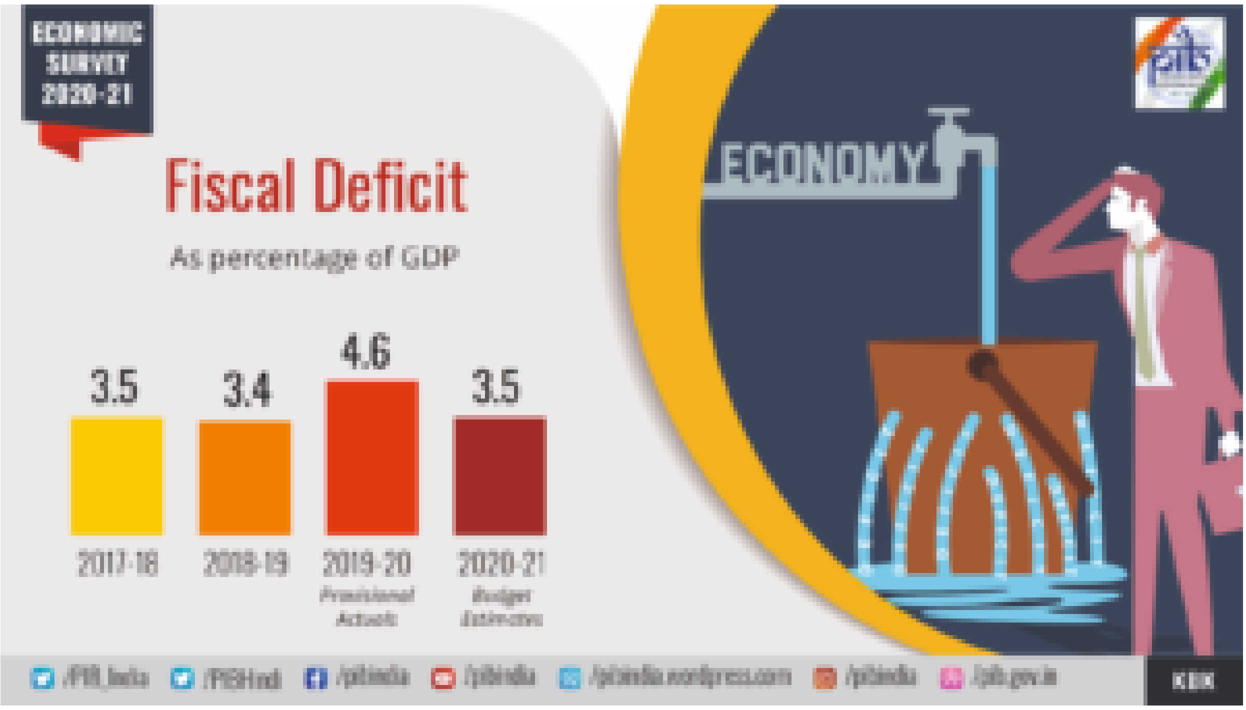
Economic Survey-2021: Fiscal Developments

January 30, 2021

- India adopted a calibrated approach best suited for a resilient recovery of its economy from COVID-19 pandemic impact, in contrast with a front-loaded large stimulus package adopted by many countries
- Expenditure policy in 2020-21 initially aimed at supporting the vulnerable sections but was re-oriented to boost overall demand and capital spending, once the lockdown was unwound
- Monthly GST collections have crossed the Rs. 1 lakh crore mark consecutively for the last 3 months, reaching its highest levels in December 2020 ever since the introduction of GST



- Reforms in tax administration have begun a process of transparency and accountability and have incentivized tax compliance by enhancing honest tax-payers' experience

- Central Government has also taken consistent steps to impart support to the States in the challenging times of the pandemic

Does Growth lead to Debt Sustainability? Yes, But Not Vice-Versa!

- **Growth leads to debt sustainability** in the Indian context but not necessarily vice-versa:
    - Debt sustainability depends on the 'Interest Rate Growth Rate Differential' (IRGD), i.e., the difference between the interest rate and the growth rate
    - In India, **interest rate on debt is less than growth rate** – by norm, not by exception
- **Negative IRGD in India** – not due to lower interest rates but much higher growth rates – prompts a debate on fiscal policy, especially during growth slowdowns and economic crises
- Growth causes debt to become sustainable in countries with higher growth rates; such clarity about the causal direction is not witnessed in countries with lower growth rates
- Fiscal multipliers are disproportionately higher during economic crises than during economic boom

Figure 19: Composition of General Government public debt

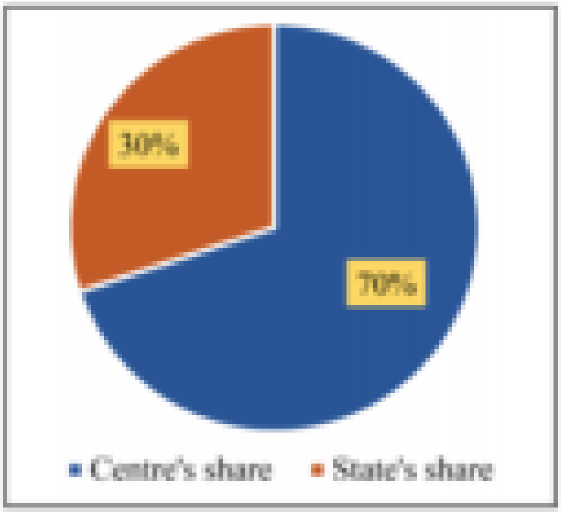
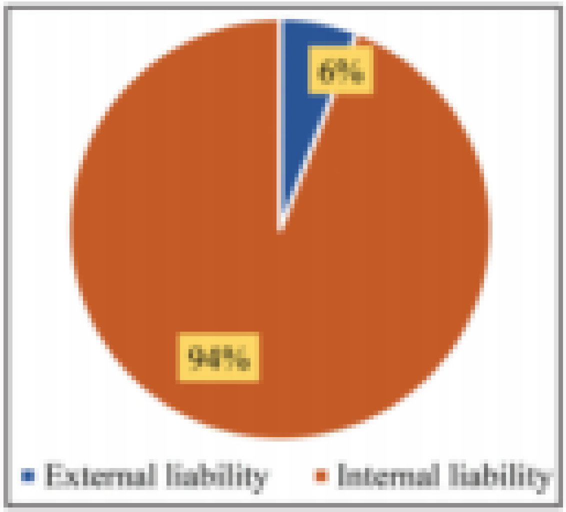


Figure 20: Composition of Central Govt. debt



- **Active fiscal policy** can ensure that the full benefit of reforms is reaped by limiting potential damage to productive capacity
- Fiscal policy that provides an impetus to growth will lead to **lower debt-to-GDP ratio**
- Given India's growth potential, **debt sustainability is unlikely to be a problem** even in the worst scenarios
- **Desirable to use counter-cyclical fiscal policy** to enable growth during economic downturns
- Active, counter-cyclical fiscal policy – not a call for fiscal irresponsibility, but to break the intellectual anchoring that has created an **asymmetric bias against fiscal policy**

Does India's Sovereign Credit Rating Reflect Its Fundamentals? No!

- The **fifth largest economy in the world** has never been rated as the lowest rung of the investment grade (BBB-/Baa3) in sovereign credit ratings:
  - Reflecting the economic size and thereby the ability to repay debt, the fifth largest economy has been predominantly rated AAA
  - China and India are the only exceptions to this rule – China was rated A-/A2 in 2005 and now India is rated BBB-/Baa3
- **India's sovereign credit ratings do not reflect its fundamentals:**
  - A clear outlier amongst countries rated between A+/A1 and BBB-/Baa3 for S&P/ Moody's, on several parameters
  - Rated significantly lower than mandated by the effect on the sovereign rating of the parameter
- Credit ratings map the **probability of default** and therefore reflect the willingness and ability of borrower to meet its obligations:

        - India’s **willingness to pay** is unquestionably demonstrated through its **zero sovereign default history**
        - India’s **ability to pay** can be gauged by low foreign currency denominated debt and **forex reserves**
    - Sovereign credit rating changes for India have **no or weak correlation with macroeconomic indicators**
    - India’s fiscal policy should reflect Gurudev Rabindranath Tagore’s sentiment of ***‘a mind without fear’***

Sovereign credit ratings methodology should be made **more transparent, less subjective** and better attuned to reflect economies’ fundamentals