

## Why will government support towards GDP growth be limited post COVID?

### Revised deficit roadmap implies much slower spending growth

- On 1<sup>st</sup> February 2021, the Government of India (GoI) presented a revised fiscal roadmap to bring down its deficit from 9.5% in FY21 (which turned out to be 9.2%, as per provisional estimates) to 6.8% of GDP in FY22 and further to 4.5% of GDP by FY26. With this relaxed deficit target, it was (and is still) argued that government spending could be a major catalyst for economic growth over the next few years.
- However, our opinion drastically **differs** from the market consensus. While the GoI has relaxed and revised its deficit target, it projects large consolidation of 0.5 percentage point (pp) of GDP every year up to FY26. It failed to bring down its deficit to 3% of GDP before COVID and was able to reach a fiscal deficit of 3.5% in FY19 (from 4% of GDP in FY15). Moreover, higher off-budget transactions meant that actual consolidation was even lower v/s the reported numbers suggested during the pre-COVID period.
- From the economic growth perspective, apart from the (qualitative) policies to encourage private investments, what matters is the (quantitative) growth in fiscal spending. In this note, we present a sensitivity analysis of likely spending growth by the central government (CG) up to FY26, assuming a revised fiscal roadmap and different receipt buoyancy. The conclusion is straightforward: even the best-case scenario suggests fiscal spending growth in post-COVID years (@8.7%) would be (much) slower than in the pre-COVID period (@11.3%).
- Furthermore, the center has allowed states to run up their fiscal deficit to 4% of GDP by FY24. When we repeat the above exercise after including states' relaxed deficit target and arrive at general government (GG) finances, the conclusion remains unchanged – even under the revised deficit framework, (combined) government spending growth in the post-COVID era (@8.6%) would be lower than in pre-COVID years (@12.5%).
- In a nutshell, our analysis confirms the government's renewed limitations to support economic growth in the 2020s decade. In fact, with slower growth than earlier, this means faster growth would be needed in private spending to achieve the same GDP growth rate. Within the private sector, as we discussed **earlier**, household finances have deteriorated further due to COVID-19, indicating likely deceleration in private consumption as well. The entire burden of achieving similar GDP growth (let alone higher growth), thus, has to be borne by the corporate sector. To our mind, it **seems** like a tall task.

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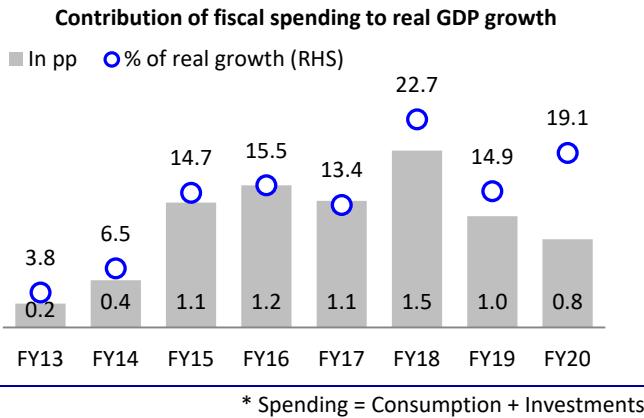
**Role of fiscal spending in real GDP growth:** It is very well known that fiscal or government spending (consumption + investments) was a major contributor to real GDP growth during the pre-COVID period. During the five-year period (FY16–20), although real GDP growth averaged 6.7%, real spending by the government<sup>1</sup> posted average growth of 8.1%. Consequently, fiscal spending contributed as much as 1.1pp each year (or 17%) to real GDP growth during the period (*Exhibit 1 on the following page*).

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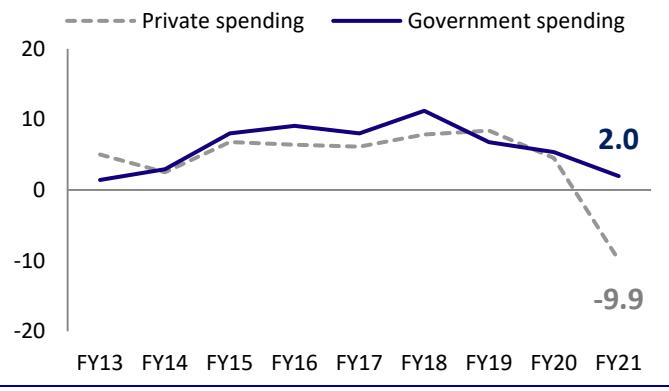
Last year, while private spending contracted 10% in real terms, government spending grew 2% in FY21 (*Exhibit 2*). Since government spending accounts for just 15% of the national economy, real GDP declined 7.3% during the year.

<sup>1</sup> Total expenditure of the government, as reported in budget documents, is different from total spending (consumption + investments) in GDP (referred to here). Since GDP considers final consumption expenditure, transfer payments or intermediate consumption are not included in GDP estimation. Further, while capital outlays of the government are considered as investments, their 'loans & advances' are excluded.

**Exhibit 1: Government spending\* has been a high contributor to real GDP growth in pre-COVID years...**



**Exhibit 2: ...and it increased in FY21 as well, when private spending collapsed**



Source: Central Statistics Office, Budget documents, CEIC, MoFSL

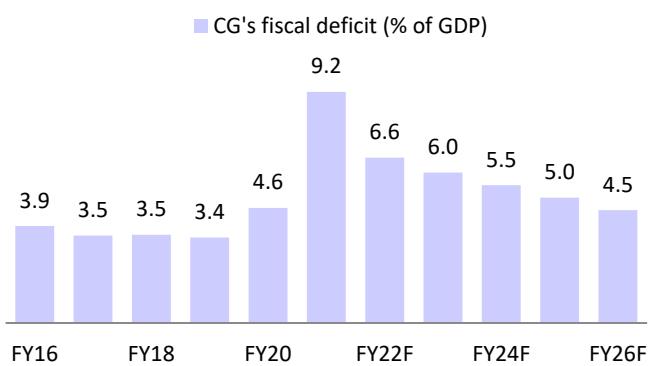
**The government is broadly expected to improve its performance...:** On 1<sup>st</sup> February 2021, GoI, while presenting the Union Budget 2021-22, announced a revised fiscal deficit roadmap to bring it down from 9.5% in FY21 to 6.8% of GDP in FY22, and further to 4.5% of GDP by FY26. With this relaxed deficit target, it was (and is still) argued that government spending could be a major catalyst for economic growth over the next few years.

Record-high spending growth in FY21RE is on account of higher subsidies.

More importantly, the majority of this spending has already been incurred.

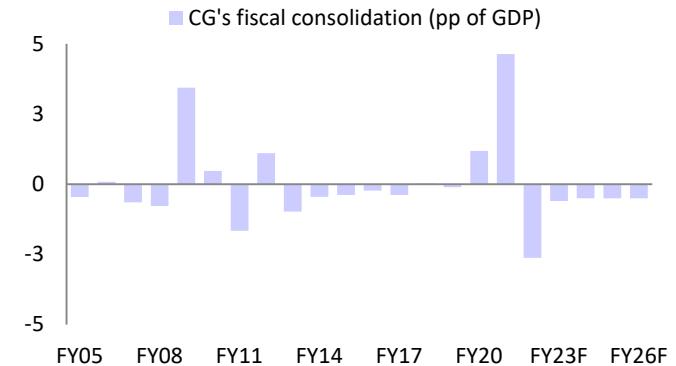
However, our opinion drastically **differs** from the market consensus. While the GoI has relaxed and revised its deficit target, a fiscal deficit of 4.5% of GDP by FY26 means large consolidation of 0.5 percentage point (pp) of GDP every year till FY26 (*Exhibit 3*). Historical data reveals the central government (CG) has achieved this feat of fiscal consolidation of more than 2pp of GDP in four years (i.e., 0.5pp per year) twice – in the mid-2000s and early 2010s – in the past three decades (*Exhibit 4*). However, the current economic environment is very weak compared with that in the mid-2000s and likely not as bad as in the early 2010s. Notably, the GoI failed to bring down its deficit to 3% of GDP before COVID. From 4% of GDP in FY15, the CG narrowed its deficit to 3.5% of GDP in FY17 and stayed at this level for three years, before COVID hit the world economy. Not to forget, higher off-budget transactions<sup>2</sup> during those years mean actual consolidation (or true fiscal deficit) was even lower (higher) than the reported numbers suggested in the pre-COVID period.

**Exhibit 3: CG's revised deficit roadmap suggests consolidation of 0.5pp of GDP every year till FY26...**



Provisional estimate for FY21 and MoFSL forecasts from FY22 based on GoI's guidance of 4.5% of GDP by FY26

**Exhibit 4: ...which was last achieved during the best growth period in mid-2000s and a very weak period in early 2010s**



Source: Budget documents, CEIC, MoFSL

<sup>2</sup> NSSF loans to Food Corporate of India (FCI) was one of the several off-budget transactions.

**...but our calculations suggest otherwise:** From the economic growth perspective, apart from the (qualitative) policies to encourage private investments, what matters is the (quantitative) growth in fiscal spending. Higher CG fiscal deficit may or may not suggest higher economic growth depending on the spending growth.

Assuming that the CG maintains its fiscal deficit roadmap, different assumptions on nominal GDP growth and receipt buoyancy would yield different expenditure estimates.

Assuming 11% GDP growth and 1.0x receipt buoyancy (15% higher v/s pre-COVID), the CG's expenditure growth in post-COVID years would be 7% v/s 11.3% pre-COVID.

Assuming that the CG maintains its fiscal deficit roadmap and narrows this down by 0.5pp of GDP each year to 4.5% of GDP by FY26, different assumptions on nominal GDP growth and receipt buoyancy (measured as receipt growth divided by nominal GDP growth) would yield different expenditure estimates. In the pre-COVID period (i.e., FY16–19), India's nominal GDP growth averaged 11% and receipt buoyancy was just 0.9x. Although tax buoyancy was much higher at 1.2x during this period, higher devolution to states (with the implementation of the 14<sup>th</sup> Financial Commission) and weak growth in non-tax receipts led to lower receipt buoyancy for the CG in the pre-COVID period.

*Exhibit 5* provides a sensitivity analysis of how different combinations of GDP growth and receipt buoyancy would lead to different spending growth, assuming the sacrosanct revised fiscal deficit roadmap (i.e., 4.5% of GDP by FY26). For instance, if nominal GDP growth averages 11% and receipt buoyancy averages 0.9x (same as that pre-COVID) in the post-COVID period (i.e., FY23–26), the CG's total expenditure would grow at 6.3% per annum. Similarly, if receipt buoyancy improves to 1.2x (two-fifths higher v/s the pre-COVID average), with 11% GDP growth, the CG's expenditure growth would average 8.4% in the post-COVID four-year period.

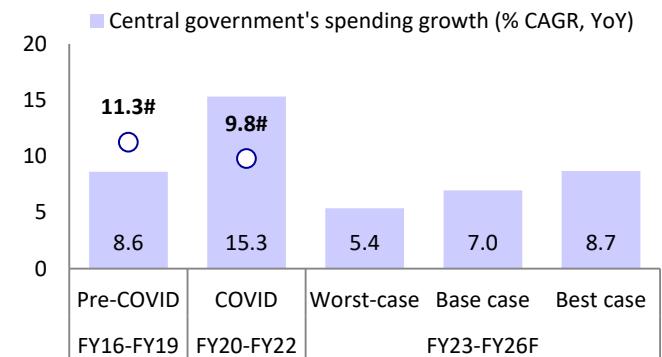
Based on reported data, the CG's expenditure growth averaged 8.6% in the pre-COVID period, which picked up to 15.3% in COVID years (FY20–22). Nevertheless, the CG pushed various expenditure items off-budget<sup>3</sup> to show a lower reported fiscal deficit in the pre-COVID period. When we adjust the reported expenditure and deficit with off-budget transactions, our calculations suggest the CG's total spending growth averaged 11.3% during the pre-COVID period and 9.8% during COVID years. If so, under our base case scenario, assuming 11% GDP growth and 1.0x receipt buoyancy (15% higher v/s pre-COVID), the CG's expenditure growth in post-COVID years would be 7% v/s 11.3% pre-COVID (*Exhibit 6*).

**Exhibit 5: Different combinations of nominal GDP growth and receipt buoyancy suggest...**

Nominal GDP growth ↓	Receipts buoyancy				
	0.8	0.9	1.0	1.1	1.2
9.0	3.9	4.5	5.0	5.6	6.2
10.0	4.7	5.4	6.0	6.6	7.3
11.0	5.6	6.3	7.0	7.7	8.4
12.0	6.4	7.2	7.9	8.7	9.5
13.0	7.3	8.1	8.9	9.7	10.6

Average nominal GDP growth was 11% and average receipt buoyancy (receipt growth/GDP growth) was 0.9x in pre-COVID period

**Exhibit 6: ...the CG's spending growth could average just 7% post-COVID v/s 11.3% pre-COVID**



# After adjusting for off-budget transactions  
Source: Budget documents, CEIC, MoFSL

<sup>3</sup>The CG pushed several expenditure such as fuel or fertilizer subsidies off-budget and through FCI as well during FY16-20, which implies that adjusted expenditure growth was higher than reported. In contrast, GoI cleared past baggage (on account of fertilizer subsidies and FCI debt) in FY21, which means that adjusted growth in total expenditure was lower than reported.

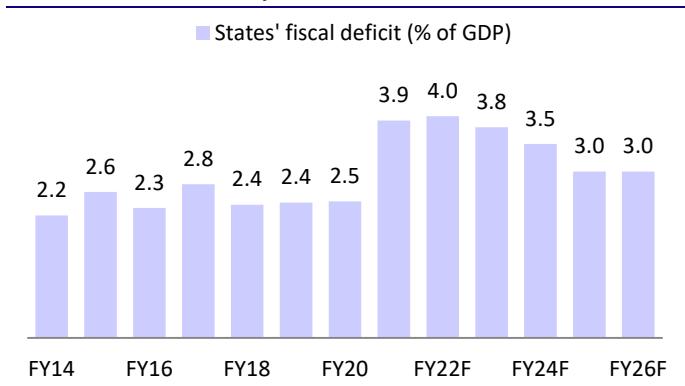
Total expenditure by state governments could grow at an average of 10.2% in the post-COVID period vis-à-vis 12.7% growth during pre-COVID years.

Even in the best case scenario (of 12% nominal GDP growth and 1.1x receipt buoyancy), the CG's expenditure growth would average at 8.7% in post-COVID years, much slower than 11.3% in pre-COVID years.

**What about the relaxed fiscal deficit for states?** The center has allowed states to run up their fiscal deficit to 4% of GDP by FY24. Provisional data suggests that while states could have run up their fiscal deficit to 5% of GDP in FY21, the aggregate fiscal deficit for the states was only ~4% of GDP. Assuming a similar deficit in FY22, gradual consolidation to 3.5% of GDP by FY24, and then 3% in FY25/FY26 (*Exhibit 7*), we repeat the same exercise for states to arrive at likely expenditure growth in the post-COVID period.

In contrast to the center, receipt buoyancy for states was 1.2x in the pre-COVID period. Assuming 11% nominal GDP growth and receipt buoyancy of 1.1x (under the base case), the total expenditure by state governments could grow at an average of 10.2% in the post-COVID period vis-à-vis 12.7% growth in pre-COVID years (*Exhibit 8*). In the worst case scenario (GDP growth of 10% and receipt buoyancy of 1.0x) and the best case scenario (GDP growth of 12% and receipt buoyancy of 1.2x), average growth in total expenditure for states would be 8.4% and 12.3%, respectively.

**Exhibit 7: Assuming states run a fiscal deficit of 3.5% of GDP in FY24 and 3% in FY25/FY26...**



Excluding UDAY-related spending in FY16-FY17  
Provisional estimate for FY21, MoFSL forecasts (F) beyond FY22

**Exhibit 8: ...their spending would also grow slowly v/s pre-COVID average growth of 12.7%**

Nominal GDP growth ↓	Receipts buoyancy				
	0.9	1.0	1.1	1.2	1.3
9.0	6.7	7.4	8.1	8.8	9.5
10.0	7.6	8.4	9.2	10.0	10.8
11.0	8.5	9.3	10.2	11.1	12.0
12.0	9.4	10.3	11.3	12.3	13.2
13.0	10.3	11.3	12.4	13.4	14.5

Average receipt buoyancy for states was 1.2x in pre-COVID period  
Source: Budget documents, CEIC, MoFSL

Even under the relaxed and revised fiscal deficit framework, (combined) government spending growth in post-COVID years would be much lower v/s pre-COVID years.

**What does this mean for combined government spending?** Combining these estimates of the central and state governments (and adjusting them for 'Grants by the center to states'), we repeat the same exercise to arrive at the estimates of the general government (GG). After applying different combinations of average nominal GDP growth (between 9% and 13%) and receipt buoyancy (between 0.9x and 1.3x), our calculations suggest the total expenditure of the GG could average at just 8.6% (under the base case) in post-COVID years, much slower than 12.5% growth (after adjusting for off-budget transactions) in pre-COVID years (*Exhibits 9, 10*). These calculations assume the combined fiscal deficit would narrow from 13.1% of GDP in FY21 to 10.6% in FY22 and further to 7.5% of GDP by FY26.

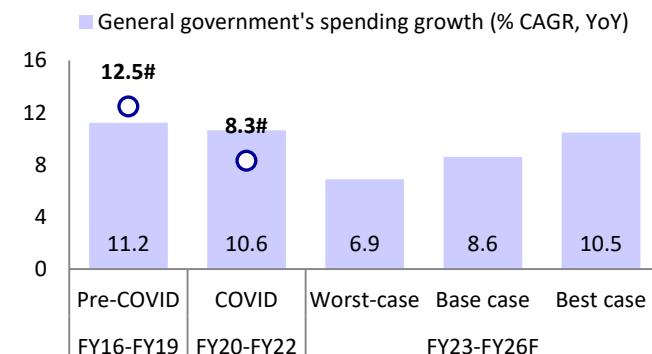
The conclusion, thus, is very straightforward – even under the relaxed and revised fiscal deficit framework, (combined) government spending growth in post-COVID years would be much lower v/s the pre-COVID period.

**Exhibit 9: Different combinations of nominal GDP growth and receipt buoyancy suggest...**

Nominal GDP growth ↓	Receipts buoyancy				
	0.9	1.0	1.1	1.2	1.3
9.0	5.3	5.9	6.6	7.2	7.8
10.0	6.2	6.9	7.6	8.3	9.0
11.0	7.1	7.8	8.6	9.4	10.2
12.0	8.0	8.8	9.6	10.5	11.3
13.0	8.8	9.7	10.6	11.6	12.5

Average receipt buoyancy of GG was 1.1x in the pre-COVID period

**Exhibit 10: ...the GG's spending growth could be just 8.6% post-COVID v/s 12.5% pre-COVID**

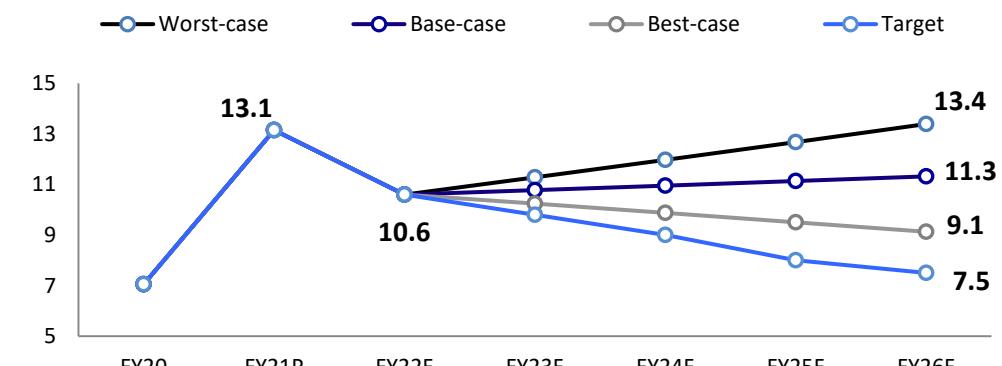


# After adjusting for off-budget transactions  
Source: Budget documents, CEIC, MoFSL

With the same nominal GDP growth (~11%) and receipt buoyancy (1.1x) as in the pre-COVID period, if GG expenditure growth is similar to pre-COVID levels (i.e., @12.5%), the combined fiscal deficit would expand slowly from 10.6% of GDP in FY22 to 11.3% of GDP by FY26.

**What if government spending growth is similar to pre-COVID levels?** What if the governments take it upon themselves to grow their spending at 12.5% between FY23 and FY26, same as in pre-COVID years? The answer is shown graphically in *Exhibit 11*. With the same nominal GDP growth (~11%) and receipt buoyancy (1.1x) as in the pre-COVID period, if GG expenditure growth is similar to pre-COVID levels (i.e., @12.5%), the combined fiscal deficit would expand slowly from 10.6% of GDP in FY22 to 11.3% of GDP by FY26 (*Exhibit 11*). In the best case (and worst case) scenario, the combined fiscal deficit would be 9.1% of GDP (13.4% of GDP) by FY26. In all scenarios, the combined fiscal deficit would be much higher than the targeted level of 7.5% of GDP by FY26.

**Exhibit 11: Projected fiscal deficit assuming GG's spending growth is the same post-COVID**



Worst-case/Base-case/Best-case scenario assumes nominal GDP growth of 10%/11%/12% and receipt buoyancy of 1.0x/1.1x/1.2x  
Source: Budget documents, CSO, CGA, MOFSL

In a nutshell, our analysis confirms the government's renewed limitations to support economic growth in the 2020s decade. In fact, with slower growth than earlier, this means faster growth would be needed in private spending to achieve the same GDP growth rate. Within the private sector, as we discussed [earlier](#), household finances have deteriorated further due to COVID-19, indicating likely deceleration in private consumption as well. The entire burden of achieving similar GDP growth (let alone higher), thus, has to be borne by the corporate sector. To our mind, it [seems](#) like a tall task.

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