

Sustainability of Fiscal Policy is the Key to Prudent Fiscal Management in India in the Aftermath of COVID-19 Pandemic: An Assessment

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Abstract: The issue of fiscal sustainability currently is being discussed in different for a as the fiscal stimulus has resulted in high level deficit and debt. Recognizing that fiscal sustainability is good housekeeping by the government and involves determining whether the government can continue to pursue its set of budgetary policies, we make an attempt to address the following questions: a) given that the real interest rate in respect of government debt is lower than the real economic growth rate should we conclude that the fiscal policy in India is sustainable? and (b) given that the key deficit indicators, viz, fiscal deficit, revenue deficit and primary deficit are at high levels relative to GDP how do we assess the sustainability in terms of fiscal reaction function, fiscal fatigue and fiscal space? Our analysis revealed that even though the Domar condition has been satisfied Indian fiscal policy in terms of fiscal reaction function found to be unsustainable. Furthermore, the fiscal fatigue continues as the fiscal deficit yet to be 3 per cent of GDP as stipulated in the FRBM ACT; besides, revenue deficit continues persistently at a higher level so also the primary deficit. Our analysis also revealed that there has been a continuous deterioration in the net worth (asset minus liabilities) and has reached 36 per cent of GDP in 2021-22 allowing less resources for development expenditure. We made an attempt to measure the scope for fiscal space for coming five years. Accordingly we worked out a fiscal road map for the years (2023- 27) in terms fiscal empowerment (maximize revenue to the budget) and reprioritizing expenditure (reversing the ratio of capital expenditure (CE) to revenue expenditure (RE)). We found that to support fiscal space revenue receipts is required to go up from around 7.9 per cent of GDP to 12.0. With regard to expenditure re –prioritization our analysis states that capital expenditure relative to GDP is required to increase to 3 per cent. Thus, the sustainability of fiscal policy remains a critical issue in Indian context. Exit from fiscal stimulus and early return to FRBM Act mandate assumes critical importance as it will not only facilitate fiscal space but also prudent fiscal management with focus on fiscal transparency and budget integrity.

Keywords: Fiscal sustainability, Fiscal Space, Fiscal Reaction Function, Fiscal Fatigue

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