WP-2023-010

Indian Fiscal Policy: A possible escape route

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November 2023

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Abstract

Historical choices, based on the interaction of domestic structure, including federalism, with global shocks and dominant ideas have left India a legacy of deficits and debt higher than peer countries. These are constraints on fiscal policy. But pragmatic choices made recently have created degrees of freedom despite continuing shocks. Better expenditure-composition, with gradual deficit-reduction, is creating human and physical capital towards inclusive and therefore sustainable growth. Inflation-lowering short and long-term supply-side action is enabling good coordination with monetary policy and countercyclical smoothing of shocks, so that real volatility reduces and interest rates stay below growth rates. Leveraging this snowball effect, as well as reduction in primary deficits, is the fastest path to bring down debt ratios. But it is necessary to bring states on board. Strengthening institutions and incentives can reduce competitive fiscal populism, and improve compliance in lower tiers of government.

Keywords: Expenditure composition, supply-side action, inclusive growth, countercyclical, coordination, snowball effect, federalism, populism

JEL Code: E62, E61, E63, E65

Acknowledgements:

I thank Charan Singh for the invitation to write on fiscal policy, Sritama Ray for research and Shreeja Joy Velu for secretarial assistance. This article draws on and updates scholarly and media articles I have written on fiscal policy through the years.

1. Introduction

A historical analysis of fiscal policy shows how economic structure, interacting with global shocks and dominant ideas, led to a decline in the share of productive government expenditure, a rise in subsidies and deficits, distortion in incentives and in resource allocation.

In contrast, recent pragmatic choices are gradually improving fiscal health despite major global shocks. Elements of these choices and the reasons why they have been fruitful, as well as much that remains to be done, are analysed in this paper.

What is new, and what is special to India about the changes? A non-ideological matching of policy to structure, and finding an effective balance between different pressures, is new. The overall policy objective is to facilitate India's catch-up growth and increase employment opportunities, while maintaining macroeconomic stability. This position is neither at the leftist redistribution extreme nor at the rightist neglect of welfare and sole reliance on markets. There is a belief in incentivizing individual agency, including through well-functioning markets, but also recognition of market-failures and of externalities that require government action.

More opportunities, provision of assets, skills and capacity building, better infrastructure and well-functioning markets provide abilities, freedoms and incentives to participate in growth. They also suit India's youthful demography and technology trends. Inadequate public goods disadvantage the poor the most since they cannot afford private substitutes. 'Antyodaya' or 'rise of the last person' can be sustained only through empowerment with assets, and is aligned with India's strength-nurturing civilizational ethos.

Hand-outs create dependence and require continuous payments. Constitutional rights may be better achieved by an emphasis on duties of providers and users, freeing time wasted in demands and agitations for productive uses. Energized bureaucrats deliver better. Impersonal tech-based systems reduce corruption. The security of own assets and release from the need to please officials is empowering. Since the last person may be handicapped, however, DBT enables non-distorting transfers to those who really need them. Since they need to be repeated, they must be well-targeted. Food security is also required for the very poor.

India showed exemplary fiscal behaviour in the pandemic and other global shocks that followed it. Government debt went up less and came down faster than major systemic economies whose imprudence is creating risks for the rest of the world.

Higher growth was sustained because of a better composition of government expenditure and reforms that enabled wider participation in growth. Excellent monetary monetary-fiscal coordination enabled countercyclical smoothing of external shocks. It kept growth high, real interest rates low and inflation within the tolerance band despite shocks. All this gives India among the best prospects for an inclusive growth-based fiscal consolidation. We examine components of the inclusive growth enabled fiscal consolidation, and see what can be done to further bring different levels of government on board.

The remainder of the paper is structured as follows. Section 2 compares outcomes in different periods and regimes. Section 3 shows why fiscal consolidation has proved elusive in India so far. Section 4 examines aspects of the current strategy for inclusive growth based consolidation and how it can be improved before section 5 concludes.

2. Comparing regimes

After independence the government largely borrowed to finance capital expenditure. There was a fiscal deficit (FD), which captures total borrowing. But the large public sector enterprises created were loss-making on average. High marginal rates and many avenues for tax evasion reduced tax buoyancy. Interest payments began eating into revenue. As subsidies rose with the international oil shocks in the seventies, the primary deficit (PD) or total borrowing net of interest payments also rose (Figure 1). By 1980-81 government consumption exceeded its income or revenue, so the revenue deficit (RD) became positive. Since borrowing for consumption does not generate an income stream it creates a charge on future tax revenue.

Government debt rose since of such borrowing for consumption, very low returns on its investments and unproductive expenditures that did not improve growth and taxes. Debt rises with the PD and the excess of the real interest rate (r) over the growth rate (g).

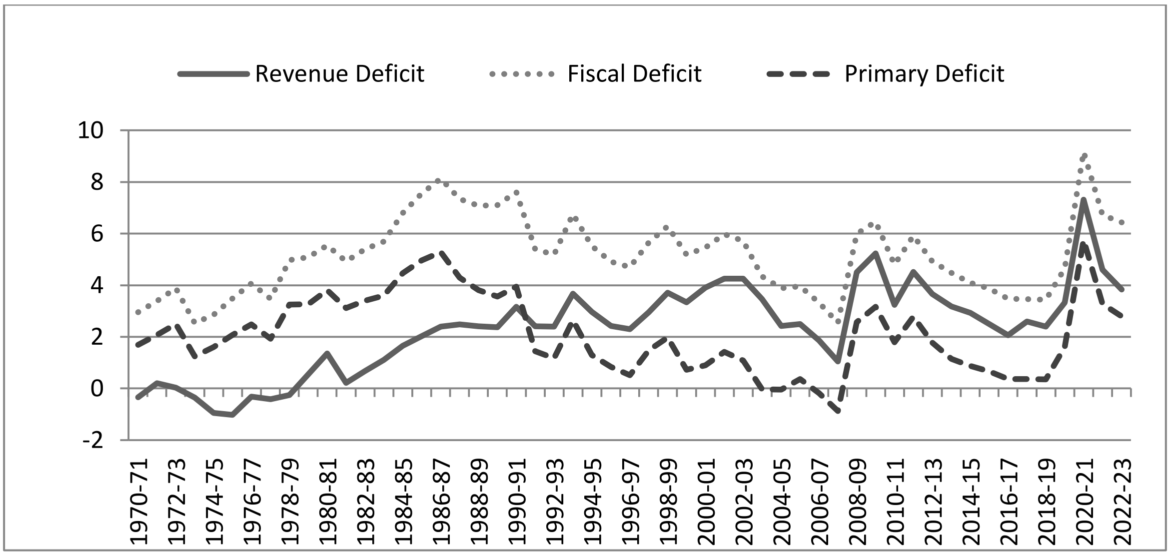
There was a realization that such deficits were unsustainable. The FD peaked at above 8% in 1986-87. Both FD and PD fell and continued falling after the liberalizing reforms of the nineties.

But the RD kept rising. The composition of government expenditure shifted from investment to consumption as committed expenditures proved difficult to cut. The sharpest fall in all three ratios came during the high growth and tax buoyant years of 2002-2008. The PD even became briefly negative.

But all three deficits rose sharply with the fiscal stimulus accompanying the global financial crisis (GFC) in 2008. Fiscal consolidation did not restart until 2012-13 and was less effective because of a growth slowdown. Spending requirements rose and deficits ratios reached their highest levels in the pandemic year as income growth was negative. But, as Figure 1 shows, now it was a peak, not a plateau unlike after the GFC. Consolidation re-started in the very next year. Ratios fell as growth recovered sharply. Absolute levels of deficits were also reduced.

Comparing the performance of the UPA and NDA regimes in deficit reduction (Table 1), overall the UPA had the best performance. But going into details reverses this assessment. The UPAs first term was the best with the advantage of high growth, but a steep deterioration followed in the second term that included the GFC. NDA managed to reverse this despite low growth, achieving the lowest FD ratio. Ratios were the worst during its second term that included the pandemic year peak. But they began to fall the very next year.

Figure 1: Central government deficits (as a % to GDP)



Source: Calculated from RBI database www.rbi.org.in.

Table 1: Comparing government performance

		RD	FD	PD
UPA	2004-05 to 2013-14	3.30	4.71	1.39
1st term	2004-05 to 2008-09	2.48	3.95	0.47
2nd term	2009-10 to 2013-14	3.41	4.80	1.52
NDA	2014-15 to2022-23	3.51	5.04	1.78
1st term	2014-15 to2018-19	2.50	3.67	0.52
2nd term	2019-20 to2022-23	4.77	6.75	3.36
	2022-23	3.84	6.44	2.79

Source: Calculated from RBI database www.rbi.org.in.

Moreover, there was a steady rise in the quality of public expenditure during the NDA period (Table 2). Although the reduction in revenue expenditure and subsidies was reversed in the pandemic year, it resumed the very next year. The shift towards capital expenditure picked up pace in the pandemic year itself. The transport sector benefitted from it. Expenditure for rural development also more than doubled.

Table 2: Select expenditure components as a percentage of GDP

	2012-13	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Interest Payments	3.15	3.12	3.10	3.08	3.04	3.43	3.43
Total revenue expenditure	14.18	10.98	10.99	10.62	11.69	15.55	13.64
Total capital expenditure	1.68	1.85	1.54	1.63	1.67	2.15	2.53
Effective capital expenditure	……	……	2.66	2.64	2.97	3.31	3.56
Total Subsidy	2.59	1.33	1.12	1.04	1.14	3.57	1.90
Rural development	0.45	0.74	0.79	0.70	0.71	1.08	0.97
Transport	0.91	0.66	0.65	0.76	0.76	1.09	1.42

3. Elusive fiscal consolidation

Intense multi party competition coincided with the large international oil price shocks of the seventies. Continuing poverty and a heterogeneous population led to competitive populism to attract voters. Prices for many public services were kept constant. Low or no user charges resulted in cross subsidies, distortions, deterioration in quality of public services and a drag that raised the RD. Or indirect charges, not obvious to voters, such as higher prices of intermediate goods, made India a high cost economy. The rich turned to private providers creating further revenue losses.

A developing country in a catch-up period tends to have *g* exceed *r* and Indian growth rates were often high. But high volatility of *g* and r reduced the contribution of this 'snowball effect' to debt reduction. Pro-cyclical rise in government spending in the 2000s high growth period was followed by over-stimulus in response to the GFC and then over-tightening after both fiscal and current account deficits widened and outflows were threatened in 2011. This made the volatility of g-r much higher than that of the PD. Between 1981-82 and 2019-20, the standard deviation of PD was only1.6 compared to 6 for g-r (Goyal, 2021). Therefore, high growth in the first period was squandered in pro-cyclical profligacy. In the second period, over-tightening of macroeconomic policy reduced the snowball effect.

Over 2004-11, *g* much exceeded *r*, but the PD as well as off-balance sheet items rose. Even so, the central government debt ratio fell 20% to 53.5. Over 2012-19, g-r fell; high *r* itself reduced *g*.

Therefore, despite the PD falling due to strenuous efforts and a much lower rise in off-balance sheet items, the centre's debt ratio fell only to 49.1 in 2019-20.

With negative growth and higher deficits India's general government debt ratio shot up to almost 90% in the pandemic year 2020 (from 75% in 2019) but fell to the mid-eighties by end 2022 as growth recovered. Interest payments to GDP ratio fell from 4.5% to 3% in 2011 but rose to 3.43 with the rise in pandemic time debt (Table 2). In 2020-21 they were 41.6 of the centre's revenue receipts.

Reducing government debt ratios is important also since they are much higher than peer East Asian economies. This raises country risk perceptions. Adverse ratings raise borrowing costs for all Indian entities.

Debt reducing consolidation requires the RD and PD to fall more than the FD to raise growth; real interest rates to stay low; growth to rise and the volatility of both reduce. It follows consolidation will be successful if it addresses each of these components. We see how current policy is attempting exactly this.

Given constraints on 'borrow and spend' the fiscal stimulus required to sustain growth comes from a better composition of government expenditure supporting feasible supply-side reforms that raise *g* and lower inflation. Higher growth and tax reform raise the tax base and reduce the PD. Moderation of inflationary supply-shocks allows monetary policy to keep real rates low, raising g-r, while anchoring inflation expectations. Such monetary-fiscal coordination enables countercyclical policy smoothing of external shocks, reducing volatility of growth. A primary surplus in good times will enable a deficit in bad times.

More revenue mobilization, however, as well as a complex of reforms to strengthen institutions and incentives for compliance at all levels of government, is required to reverse past trends.

4. Components of the inclusive growth-based consolidation strategy

4.1 Increasing physical and human capital

While growth raises the denominator of debt and deficit ratios, as well as tax revenue, broad inclusive growth is more sustainable.

As we see in Table 2, despite limited room since about 40% of central revenue receipts go in interest payments, government expenditure was shifted towards infrastructure investment and creating assets for the poor. Infrastructure investment has the highest output multipliers and spill over to the private sector (Goyal and Sharma, 2018). The private sector alone under-provides this since it has a short-horizon and does not internalize the externalities created. But public infrastructure investment can crowd in and revive private investment by reducing costs and supply bottlenecks. This better composition of public expenditure compensates for market failure instead of creating loss-making public enterprises.

The poor are more dependent on public goods and infrastructure since the rich can pay for substitutes. Better private and public assets increase agency of the less well-off and the market size for inducing inclusive market-led innovations (Goyal, 2017), which are a characteristic of the digital age. India's youthful demography[1], technology trends and strength-nurturing civilizational ethos multiply such innovation.

A Multidimensional Poverty Index gives evidence of such empowerment. An additional 135 million people had adequate access to access to sanitation, nutrition, cooking fuel, financial inclusion, drinking water and electricity in 2019-21 over 2015-16 (UNDP, 2023).

As more participate in growth it broadens, deepens and sustains, reducing debt and deficit ratios. Technology enables transfers to those who really need them. Direct benefit transfers do not distort prices and their impersonality reduces leakages and corruption. But transfers do not shift the poor to dynamic higher income paths. They must be well-targeted since a one billion plus population with a narrow tax base make broad welfare measures infeasible.

Nutritional security is a necessity for the very poor and a pre-requisite for human capital. Populous East Asia achieved its growth transition by first raising agricultural productivity to ensure a low-priced consumption basket of essentials. India provides food security through complicated distorting farmer and consumer subsidies that have sustained inflation in the past. These will shrink as poverty falls and agricultural productivity rises.

4.2 *Feasible reforms*

There is a large feasible set of reforms that can ride current tech trends that mesh with India's comparative advantage and are compatible with its political economy.

In a democracy interest groups ask for benefits and then justify their continuation. Any reform that affects large groups attracts costly protests. The land-labour-agriculture liberalizing reforms that are favourites of foreign capital fall in this category. But these controversial reforms are not pre-

[1] In 2022, India's estimated average age of 28.7 and dependency ratio of about 0.4 were about the lowest in the world.

requisites since growth has recovered without them. They can be left to states, as they follow strategies successful elsewhere in competing for capital[2]. States that reform will be able to attract more of the green finance coming in.

Examples of successful reforms that improved local facilities and reduced costs include public digital goods that improved public services; rationalizing laws, regulations and taxes; easing compliance; improving infrastructure and lowering logistics costs. GST creates one market by reducing overlapping taxes. Industrial policy is trying to encourage export competition, sunrise high-tech and green industry, capture opportunities in supply-chain diversification and to create jobs through temporary and well-targeted incentives. Time-barred schemes create much better incentives. Such schemes worked well in pandemic times and should be more widely utilized.

To fully harness potential innovation in the context of India's youthful population, much work needs to be done on education, skilling and infrastructure apart from improving legal/police/local administrative services. Good prospects for a high growth catch-up period make this India's time for an agreement on an inclusive social contract that delivers growth.

4.3 Faster consolidation

Although growth brings down debt and deficit ratios, PDs add to debt. Given the history of large debt and deficits, PDs should fall in good times. This would give faster consolidation and creates counter-cyclical buffers.

Periodic jumps in deficits and debt were not adequately reversed and there was trend deterioration in the composition of government expenditure. Maintaining stimulus too long after the global financial crisis led to over-tightening and low growth in the 2010s.

Post pandemic policy differs. India offers the opportunity to move towards an ideal of low taxes on a large base to decrease PDs. The intensive use of data, tax simplification and rationalisation has increased revenue buoyancy and has further to go.

Targeted expenditure and restructuring and leveraging poorly utilized large public assets are other feasible strategies. Asset monetization improves efficiencies as well restructures government towards supporting human and physical capital formation, which has the maximum spill-overs. It also offers opportunities for public private partnership, as government can de-risk projects, in line with its comparative advantage.

[2] When states that implemented VAT in 2007, to replace the old origin based system of interstate sales taxation gained revenue, others followed.

4.4 Fiscal-monetary coordination

Fiscal action is more effective against supply shocks that account for about half of Indian inflation. Apart from commodity price shocks, general business costs are high. A large youthful population and rising retail and housing loans make demand more interest elastic. Since the government and the central bank each can help achieve the other's objective, coordination can give the best results.

More public investment reduces bottlenecks and chronic cost push over time. Among shorter-term measures the government's long history of intervention in the food economy proved useful under global food price shocks. Countercyclical oil excise tax reduced pass-through of global oil price volatility, even as longer-term reforms reduced oil intensity.

Such fiscal actions enabled monetary policy to keep real interest rates at equilibrium low enough to support growth and reduce risk, yet give savers positive real returns on average. This implies nominal policy rates rise with inflation, which is enough to anchor inflation expectations. Coordination is compatible with central bank independence and credibility of inflation targeting since accommodation is conditional on inflation. Such combined control of inflation has the least cost in terms of growth sacrifice. Lower interest rates also reduce government's cost of borrowing and support investment.

Leeper (1991) shows if deficits are high, monetary policy must accommodate fiscal policy in order to prevent a debt explosion. If, however, monetary policy is actively raising rates fiscal policy must become conservative to prevent a debt explosion. One or the other has to take the lead. But India's economic structure gives an opportunity for monetary-fiscal coordination. Each side has incentives to deviate, however. So delegation to a more pro-growth governor and more conservative finance minister makes cooperation the unique credible equilibrium (Goyal, 2018). India was lucky to have this combination during the pandemic period.

Real interest rates below growth rates reduce debt ratios. Post reform India lost this advantage because of high volatility of growth and rates. Post pandemic countercyclical policy successfully reduced volatility. The next section discusses how.

4.5Countercyclical policy

Although external risks continue, the Indian economy is showing signs of having reached a level that absorbs and moderates shocks. In a large and diverse country even during a global slowdown some sectors continue to do well despite others slowing. For example, in 2023 even as manufacturing exports slowed, robust services exports and remittances reduced the current account deficit. More openness itself increases diversity; also correlation across sectors remains low during a catch-up process.

During and after the pandemic period, counter-cyclical macroeconomic policy also played a smoothing role, enabling growth to continue and inflation to moderate despite shocks. Research finds some late starters, with better polices, including openness to new technology, trade and to more efficient forms of organisation, grow rapidly after crossing a certain threshold and doubled per capita incomes in ten years. India reached this threshold in 2000. There was doubling in the 2000s but not in the 2010s. One reason was fiscal-monetary-financial policy veered from over-stimulus after the GFC to over-tightening in the 2010s, despite the capital flow surges of the quantitative easing decade. Fiscal policy was focused on reducing debt and on reforms; monetary policy on strictly implementing inflation targeting to get inflation to 4% and on financial regulation. The emphasis on structural reform led to a neglect of cyclical smoothing. Past periods of higher growth saw a substantial jump in investment—public pre-reform and private after. But macroeconomic volatility raised rates and aborted investment cycles. India's catch-up growth was volatile since external shocks were aggravated rather than smoothed.

Although deficit expansion was restrained during the pandemic, a better composition and targeting of expenditure provided stimulus. An example of the nuanced balance between demand and supply-side initiatives was that while positive deficits continued to support demand, the change in type of deficits also improved the supply response. Since excise was raised when international fuel prices fell, space was available to cut when they rose without raising subsidies. Given the extreme volatility of international commodity prices in this period countercyclical use of excise and other interventions in the food economy was necessary to moderate pass through and help anchor household inflation expectations, although the longer-term movement to movement to market-determined pricing should continue.

Government long and short term inflation lowering supply-side interventions helped the Reserve Bank of India (RBI) monetary policy committee (MPC) keep real interest rates low and below growth rates, so the snowball effect could bring down debt ratios.

But keeping real interest rates near equilibrium, when the US Fed was raising rates sharply, required demonstrating independence from US policy. Following the Fed in 2013 and 2018 contributed to India's decade long growth slowdown, interrupting the possible decadal doubling.

4.5.1 Policy independence

Fiscal policy had not followed the US in making large income transfers despite much pressure to do so. In hindsight its well-targeted support worked out better. Excess demand did not aggravate inflation, unlike in the US.

India’s interest rate spreads with the US had widened during the pandemic as the Fed cut rates to zero but the MPC cut the repo only to its inflation target of 4% in mid-2020. The Fed began raising in March and India in May 2022. Big steps brought the Indian repo to 6.50% in February and the Fed rate to 5.25-.50% in July 2023, with a pause after that. Markets were uncomfortable with narrowing spreads under large post Ukraine war outflows, and again in 2023 as the MPC paused and the Fed kept raising rates.

The MPC communicated repeatedly that Indian policy had the freedom to respond to the domestic cycle. There were many reasons why narrowing interest differentials were not a concern. Uncovered interest rate parity (UIP) tells us under free capital flows Indian nominal interest rates must equal those of the US + expected depreciation+ country risk premium.

But more stable Indian macros, lower inflation differentials and stable growth, among highest in the world, was reducing country risk premium, as was growing economic size and diversity. Unlike the US, excess demand or tight labour markets were not driving Indian inflation. There were no second round effects from supply-shocks. Fiscal policies were moderating the latter. The sensitivity to commodity prices had also waned.

Timely regulatory and other relief to the financial sector, as well as its timely withdrawal, had prevented moral hazard, reduced risk and interest rate spread. BIS credit data for 2021 shows Indian firms and household leverage to be about half of the EM average, while government debt was about double. The financial sector was stronger. It was lending more to retail helping private debt to rise as required.

Interest differential sensitive inflows were still not fully free in India. Carefully sequenced moves to capital account convertibility had started by freeing equity inflows, while caps on debt flows (as a percentage of the domestic market) continued. Therefore capital affected by UIP was small as a share of the market. Total debt capital in India had stayed constant at around $100bn while equity inflows had returned even as differentials narrowed.

Returns to fixed income flows depend more on currency movements and country risk. Multiple instruments such as India’s large FX reserves and macro-prudential regulation were used to prevent real exchange rate misalignment under global risk-off outflows as the Fed raised rates. Research shows that excess UIP premium is around 3% in emerging markets (EMs). Excess returns exceed actual depreciation, and the premium is aggravated by excess volatility (Goyal and Ray, 2023). Therefore the theoretical recommendation of a free float with inflation targeting does not work in EMs where depreciation leads to further outflows, self-fulfilling depreciation and persistent real deviation from competitive exchange rates. Since the international financial architecture offers hardly any support to EMs all EM inflation targeters hold reserves as buffers and their central banks intervene to reduce excess volatility. Markets tend to have more confidence in countries with large buffers for self-insurance. Intervention can abort pass-through to inflation from exchange rate over-depreciation.

The RBI was able to use its buffers effectively to respond to the domestic cycle despite US over-reaction and global excess volatility. Reserves fell in 2022 but had recovered by 2023.

4.6Strengthening compliance in lower tiers

Goyal (2011) introduced a dynamic debt equation in a (DSGE) open economy model with structural features of the Indian economy. An application of the analysis to and assessment of post reform Indian debt and deficit ratios showed less than warranted reduction in debt ratios in high growth phases and if debt is already high. This was the procyclical Indian fiscal response during the 2000s high growth period. It follows stronger institutional restraints may be required to ensure countercyclical deficits and policy certainty across heterogeneous governments.

Governments have to be committed to consolidation for it to happen, since they can always find escape routes, despite discipline from a large share of interest payments, rating agencies and foreign portfolio outflows for the centre and from limits to borrowing and fiscal responsibility legislation for the states. With higher growth, delivery and governance have also begun to matter for electoral performance as they enable participation in new opportunities.

The centre has demonstrated relatively conservative preferences. Political stability has also allowed it to take a long view. Transparency, with clarity on off balance sheet items, has improved in the centre but it is not uniform in lower tiers.

There is a trend towards competitive pre-election promises of freebies in states—which we define as hand-outs that do not build capacity. The continuous payments required worsen finances. These are largely financed by cutting investment, the quality of public services, or shifting problems to future governments. Schemes self-sustain by creating interest groups. They waste limited resources since they are rarely terminated or rationalized. Each government starts new ones. Despite rationalization, central schemes have expanded again, but most of them now build capacity.

But states have to participate for outcomes on health and education to improve. More has to be done to improve state capital expenditure (capex), the performance of public utilities, align overlapping state and central rights and responsibilities and delegation to the third tier, which is the point of delivery of public services.

The overlaps, and the detour of planning, have created inefficiencies, although India's federal structure has the required mix of discipline and support for states. Income tax rights are given to the centre because of basic economic principle (of subsidiarity); otherwise household migration to low tax states would reduce tax revenues. Devolutions from independent Finance Commissions (FCs) ensure equity. Over the years they have imposed sharing in almost all taxes. Limits on state borrowing are required to prevent macroeconomic instability. States do have to get the centre's permission for market borrowings. But market discipline is limited, since the RBI backstop allows all states to borrow at the same rates[3].

Also constitutional provisions towards delegation have been flouted by all political parties. An excuse often made is lack of local capacity[4]. But for 20 years now successive FCs have increased grants to local governments conditional on capacity building and better accounting. There are complaints these cannot be utilized because of the conditionalities. If capacity creation is taking so long it points to political obstacles.

States governments are able to sidestep attempts at discipline by local institutions and banks that are dependent on them. Political deal-making offers another escape route. But discipline and incentives imposed by independent central/ constitutional institutions have worked. A package the 12th Finance Commission offered was able to reduce state debt. Arbitrary pricing (such as free electricity) is especially harmful since such measures distort resource allocation. After repeated failures, a recent set of incentives have led to improvement in state electricity distribution companies (DISCOMs) health, because of conditionalities such as restricting open access and penalties imposed by the Power Finance Corporation through an automated online process with a clear standard operating procedure. Carrots were offered as well as sticks. For example, the post-pandemic 50 year interest free year loan, is part conditional on capex and power reform.

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[3] According to the OECD network on fiscal relations in 2022, at 28% Indian subnational debt was the 4th highest in the world. The OECD average is 20%. With regard to standard deviation of yield variation across states India at 0.06 was at the bottom. In Mexico it was 4.6%, in S Africa 1.5%.

[4] Municipal corruption is said to be the major constraint in the entry and expansion of firms.

NITI clones being set up in states should therefore focus on better measurement, which is essential for monitoring conditionality and delivery. But the monitoring itself is better done by national bodies, voter groups and markets.

The Election Commission can help voters understand that freebies are never free by asking parties to estimate costs of schemes and also announce what tax will rise or what expenditure be cut to finance poll promises. Better measurement will enable the imposition of PAYGO rules, so that a new scheme can be announced only if the funding for it is shown. It is also a prerequisite if financing of select schemes is to change to output based from input based. The latter has resulted in strategic behaviour. Budget process rules also improve outcomes.

Property tax was recently ring fenced, to make municipalities more credit worthy and allow them to enter the municipal bonds market. Pressures such as market determined interest rates would support these initiatives. A part of GST could be devolved to the 3rd tier, with some guard rails. Efforts at asset monetization need to be intensified at all tiers of government.

FCs were mandated to achieve uniform public services through the country. Incentives for better compliance may finally deliver this helping make growth inclusive and sustainable.

5. Conclusion

Indian government debt and deficits have been rising since the seventies. Successive governments have struggled to reduce them, with limited success. Debt ratios fall if growth exceeds the real interest rate (known as the snowball effect) and the primary deficit converts to a surplus. Although post reform Indian growth has been higher, it and the real interest rate have been more volatile, aborting the snowball effect.

Moreover, the two components did not reinforce each other. In periods when growth was high, such as the 2000s, government revenue expenditure increased the primary deficit. Fiscal policy was not countercyclical. In the 2010s lower growth reduced the impact on debt ratios despite strenuous consolidation efforts. But post pandemic the attempt to sustain broad inclusive growth; keep real interest rates low; reduce the volatility of both; while improving the composition of government expenditure towards supporting growth and reducing inflation is already delivering results. Different components are working together towards an effective inclusive growth based fiscal consolidation.

Some strengthening of institutions, and supportive incentives, has increased state capex and the performance of DISCOMs. More of this is required to bring states on board, reduce competitive fiscal populism and finally reach the constitutional promise of good quality uniform public services through the country. This would empower the disadvantaged to participate in and gain from the country's growth.

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