INDIAN DEMOCRACY AT WORK

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National Round Table on

# A VIABLE FRAMEWORK FOR FISCAL PRUDENCE

## 4TH NOVEMBER 2023

## INDIA INTERNATIONAL CENTRE, NEW DELHI

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**If India wins, who loses? If India loses, who wins?**

**Pandit Jawaharlal Nehru**

# India's Growth Momentum

## Prospects of a Moderately High Growth on a Sustained Basis

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| Growth Projections for Major Economies (Real GDP, in %) | | |
|---|---|---|
| **Country** | **Year 2024** | **Year 2028** |
| **United States** | 1.5 | 2.1 |
| **China** | 4.3 | 3.4 |
| **United Kingdom** | 0.6 | 1.5 |
| **India** | 6.3 | 6.3 |
| **Germany** | 0.9 | 0.9 |
| **France** | 1.3 | 1.4 |
| **Japan** | 1.0 | 0.4 |

**Source:** World Economic Outlook 2023, International Monetary Fund

- Various estimates by World Bank, OECD and S&P Global among others, have predicted a **moderately high growth rate for India.** Projections estimate a steady growth rate of **6.8%** in the next 5 years (fiscals 2024-2028), fairing a higher average than other major economies.

- India is expected to be the third largest economy in the next few years, owing to the **consistent efforts targeted at economic growth by successive governments** along with a **favourable global climate**. However, these projections can only be realised by continued responsible fiscal management.

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# Fiscal Management –

# A Threat to India's Growth

# States' Fiscal Equation: Current Expenditure Exceeds Total Revenues

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| Revenue Balance of Select States (% of GSDP) | | | |
|---|---|---|---|
| States | Revenue Deficit (-) / Revenue Surplus (+)[1] | | |
| | 2019-20 | 2020-21 | 2021-22[2] |
| Andhra Pradesh | -2.74 | -3.5 | -0.72 |
| Telangana | -0.66 | -2.3 | 0.38 |
| Tamil Nadu | -2.06 | -3.45 | -2.25 |
| Punjab | -2.66 | -3.25 | -3.16 |
| Rajasthan | -3.64 | -4.34 | -2.98 |
| Kerala | -1.76 | -3.23 | -3.54 |
| Uttar Pradesh | 3.95 | -0.12 | 1.26 |
| Madhya Pradesh | -0.30 | -1.88 | -0.49 |
| West Bengal | -1.63 | -2.27 | -2.15 |
| Jharkhand | 0.61 | -0.98 | 0.14 |
| Chattisgarh | -2.79 | -1.96 | -0.26 |
| Himachal Pradesh | 0.01 | -0.06 | 0.64 |
| All States | -0.6 | -1.9 | -0.9 |

**Source:** Analysis of State Budgets of Major States 2022-23 in India, National Institute of Public Finance and Policy; States' Finances Audit Reports, C&AG

- Many State Governments are incurring revenue deficits, which means that **current day-to-day expenditure is financed by borrowing.** Instances of States' revenue deficit exceeding 1% of GSDP have been highlighted in red in the Table.

- According to the **'Golden Rule'** of public finance, in the absence of economic emergencies, **no economic agent should borrow to finance current consumption**, and therefore a long-term target for governments should be to maintain a zero revenue deficit.

# Union's Fiscal Equation: The Hidden Structural Deficit

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| Structural Deficit of the Union Government (₹ Crore) | | | | | | |
|---|---|---|---|---|---|---|
| | **Heads** | **2019-20** | **2020-21** | **2021-22** | **2022-23 RE** | **2023-24 BE** |
| **A** | Gross Revenue of the Union Government | 2,151,083 | 2,137,859 | 2,913,780 | 3,220,865 | 3,571,508 |
| **B** | Resources Transferred to States and UTs with Legislatures | 1,282,648 | 1,355,293 | 1,778,224 | 1,852,702 | 2,010,785 |
| | *Devolution of States share in Taxes* | 650,678 | 594,997 | 898,392 | 948,406 | 1,021,448 |
| | Other Transfers including Finance Commission Grants and Centrally Sponsored Schemes | 631,970 | 760,296 | 879,832 | 904,296 | 989,337 |
| **C** | Salaries and Pensions (including Defence) | 618,935 | 673,919 | 634,725 | 724,364 | 737,930 |
| **D** | Interest Payments | 612,070 | 679,868 | 805,499 | 940,651 | 1,079,971 |
| **E** | **Net Resources available with the Union (A-B-C-D) / Structural Deficit of the Union** | **-362,570** | **-571,221** | **-304,668** | **-296,852** | **-257,178** |
| **F** | Revenue Deficit (-) | -666,545 | -1,449,599 | -1,031,021 | -1,110,546 | -869,855 |
| **G** | ***Revenue Deficit as a percentage of GDP (-)*** | ***-3.3*** | ***-7.3*** | ***-4.4*** | ***-4.1*** | ***-2.9*** |

**Note:** Gross Revenue excludes Dividends and Profits.

**Source:** Preserving Growth Momentum, A Politically Viable Framework for Fiscal Prudence, *Foundation for Democratic Reforms*

# Ballooning Debt Burden

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| Debt Burden of Select States (FY 2023) | | |
|---|---|---|
| **State** | **Outstanding Liabilities to GSDP (exclusive of Government guarantees, in %)** | **Total Liabilities to GSDP (inclusive of Government Guarantees, in %)** |
| **Andhra Pradesh** | 33.58 | 44.11 |
| **Telangana** | 28.32 | 38.31 |
| **Tamil Nadu** | 32.09 | 36.00 |
| **Punjab** | 47.81 | 52.71 |
| **Rajasthan** | 37.99 | 45.26 |
| **Kerala** | 39.10 | 42.76 |
| **Uttar Pradesh** | 34.67 | 43.06 |
| **Madhya Pradesh** | 28.62 | 31.63 |
| **Odisha** | 14.86 | 15.66 |
| **Himachal Pradesh** | 41.36 | 42.32 |
| **Chhattisgarh** | 28.54 | 30.34 |
| **Jharkhand** | 34.32 | 35.23 |
| **West Bengal** | 34.41 | 39.97 |
| **Karnataka** | 23.88 | 25.51 |

**Source:** Preserving Growth Momentum, A Politically Viable Framework for Fiscal Prudence, *Foundation for Democratic Reforms*

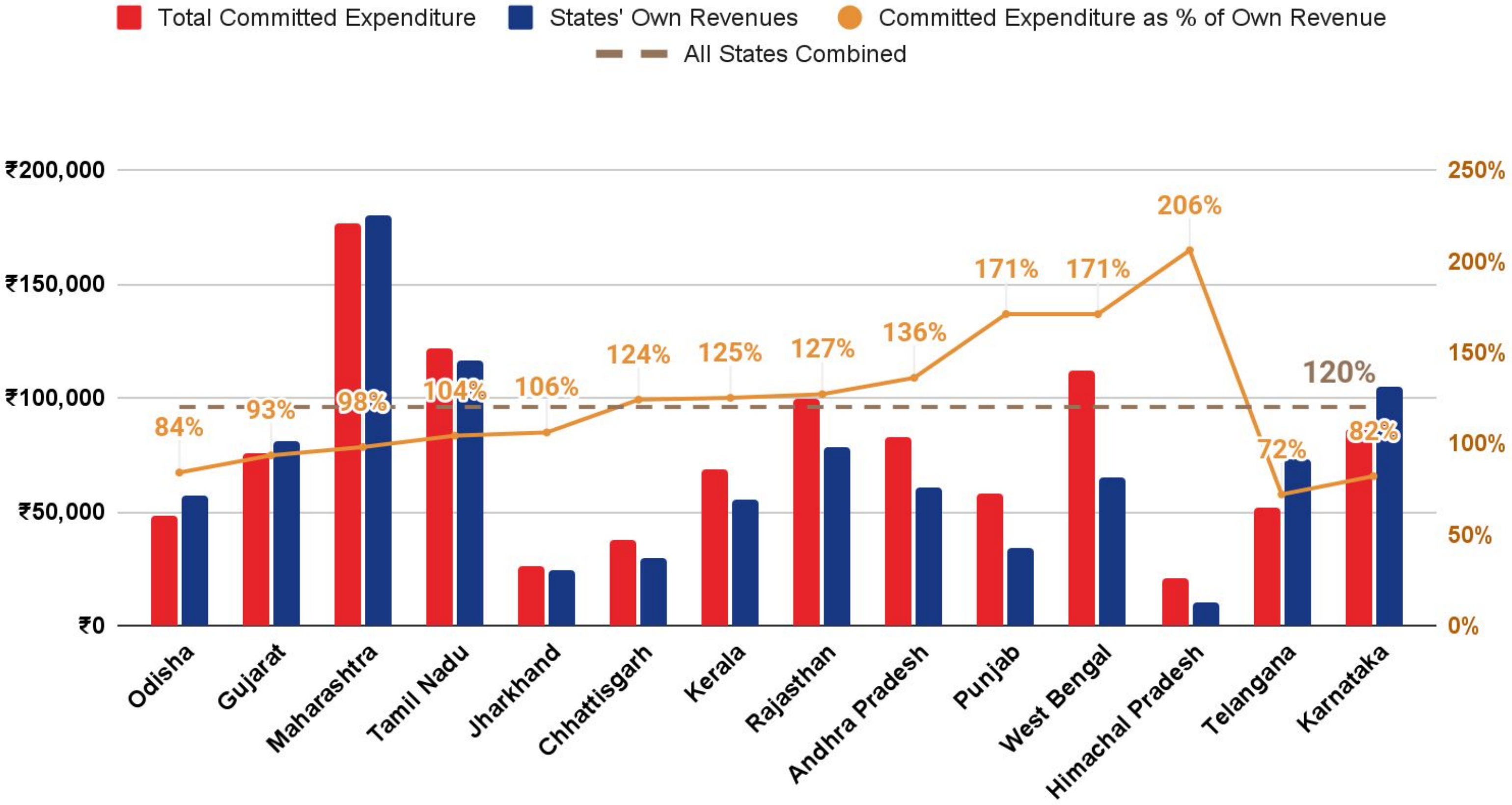
- The **Union debt is at 57%** of GDP (2022-23 RE). **States' cumulative debt (2021-22 RE) is at 28.7%** of GDP and budgeted at 29.5% for 2022-23, as against the FRBM norms of 40% and 20%, respectively, for the Union and States

- The **real debt-GDP ratio of States,** including off-budget borrowings, is of the order of **34%** by end of fiscal year 2022-23.

- There are instances of **repeated deferrals and postponements of bills** in States to the order of tens or thousand of crores, putting the actual liabilities of States at an even higher level.

# States' High Committed Expenditure: Squeezing Core Governance

## Committed Expenditure vs. Own Revenues in Select States, 2020-21

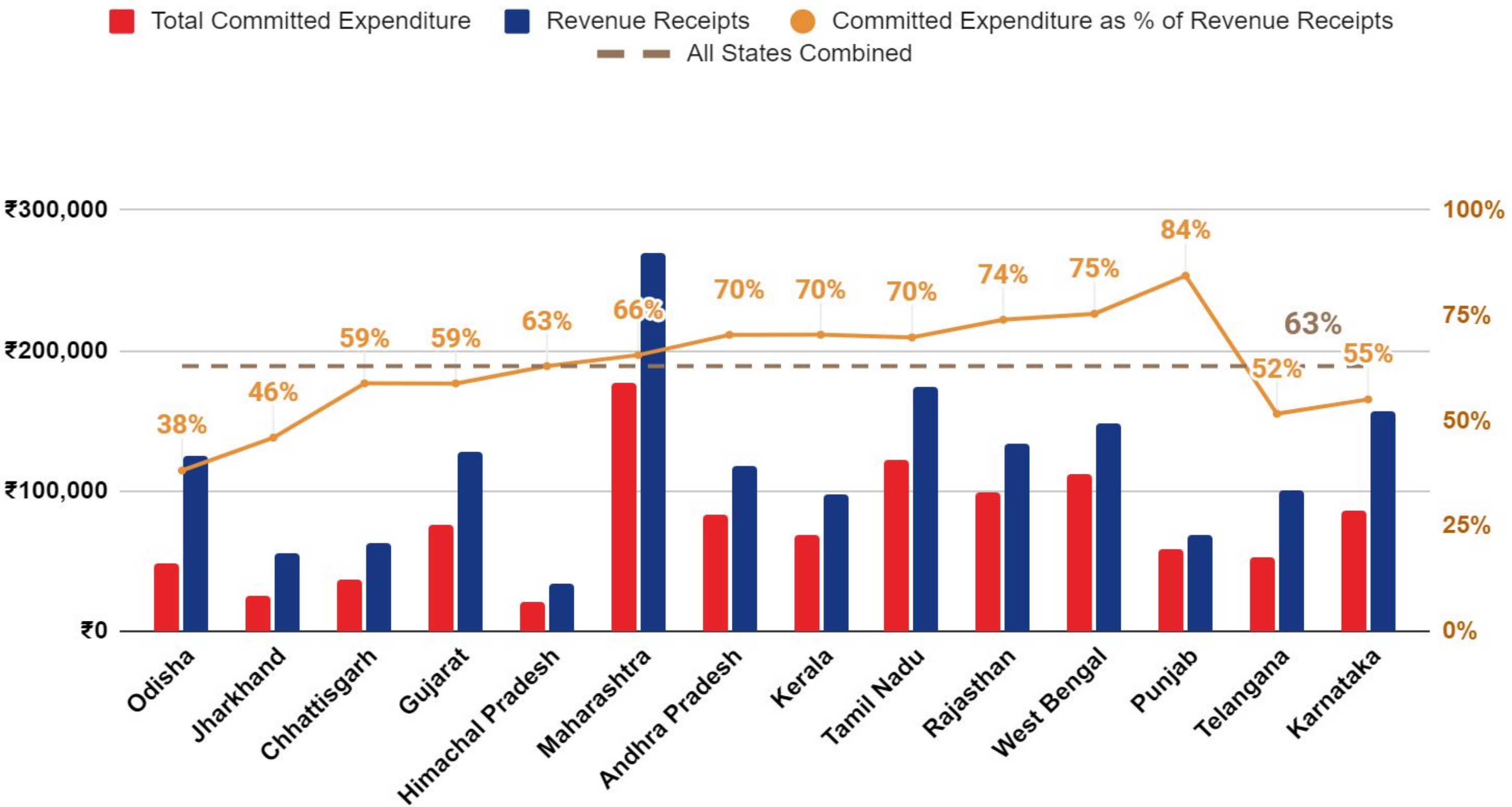



**Note:** Committed expenditure includes salaries & wages, pensions and interest payments. States' own revenues excludes Union transfers.

**Source:** State Finances: A Study of Budgets 2022-23, RBI

# States' High Committed Expenditure: Squeezing Core Governance

## Committed Expenditure vs. States' Total Revenues in Select States, 2020-21

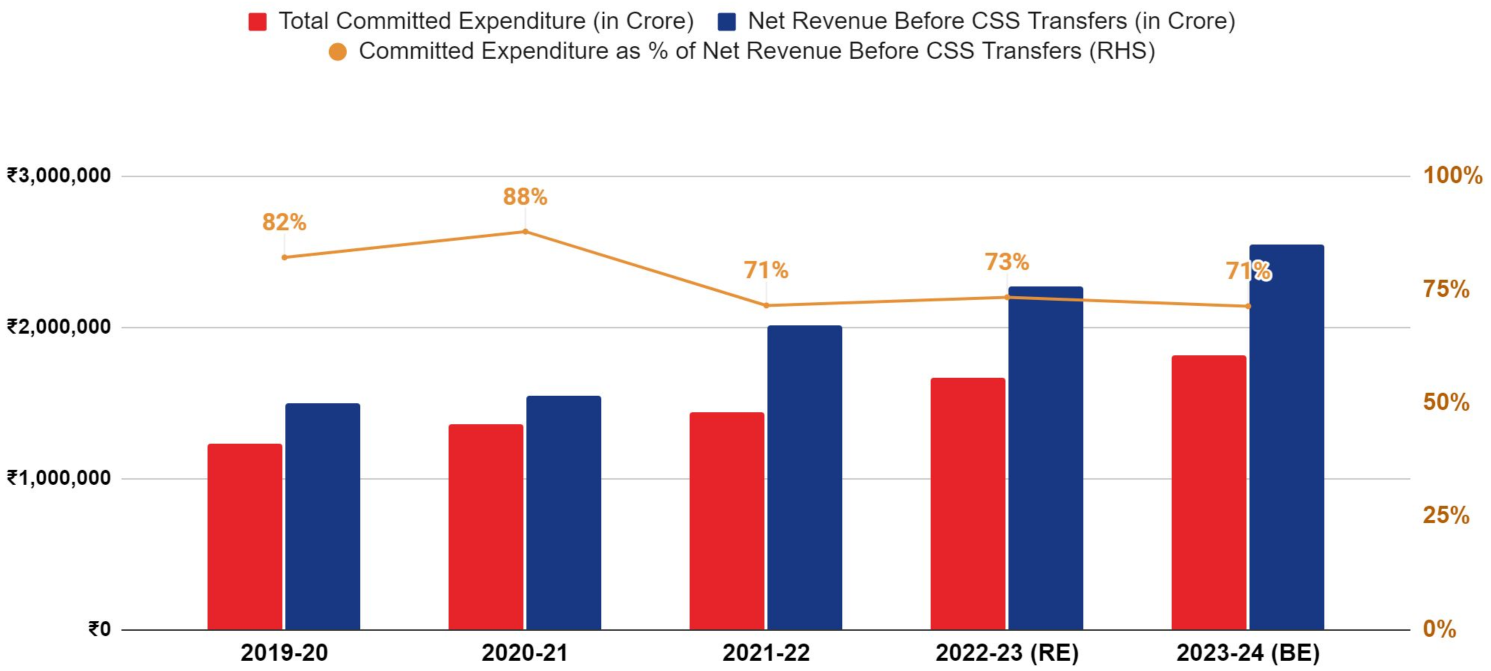



**Note:** Committed expenditure includes salaries & wages, pensions and interest payments. States' total revenues includes Union transfers.

**Source:** State Finances: A Study of Budgets 2022-23, RBI

# Union’s Committed Expenditure: Squeezing Core Governance

## Committed Expenditure vs. Union’s Net Revenues before CSS Transfers




Note: Committed expenditure includes salaries & wages, pensions and interest payments. CSS: Centrally Sponsored Schemes

**Source:** Union Budget Documents

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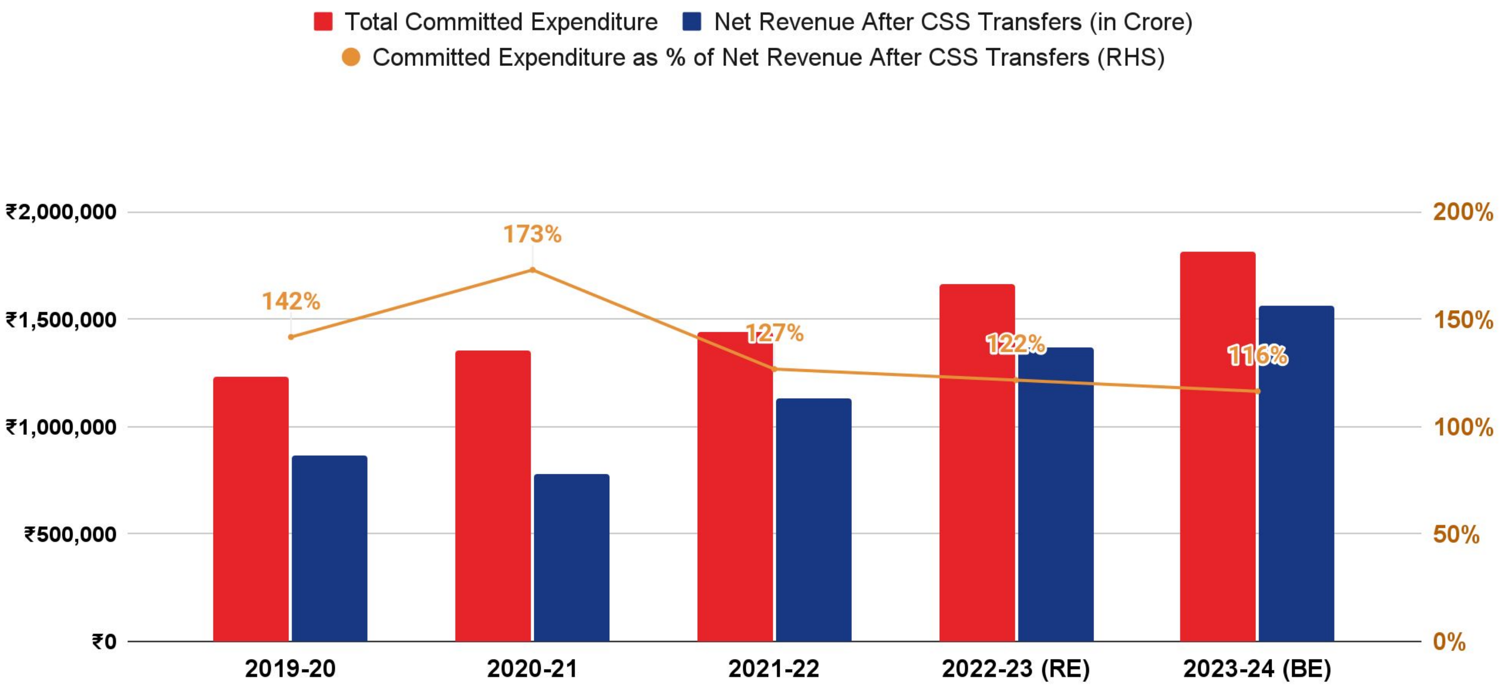
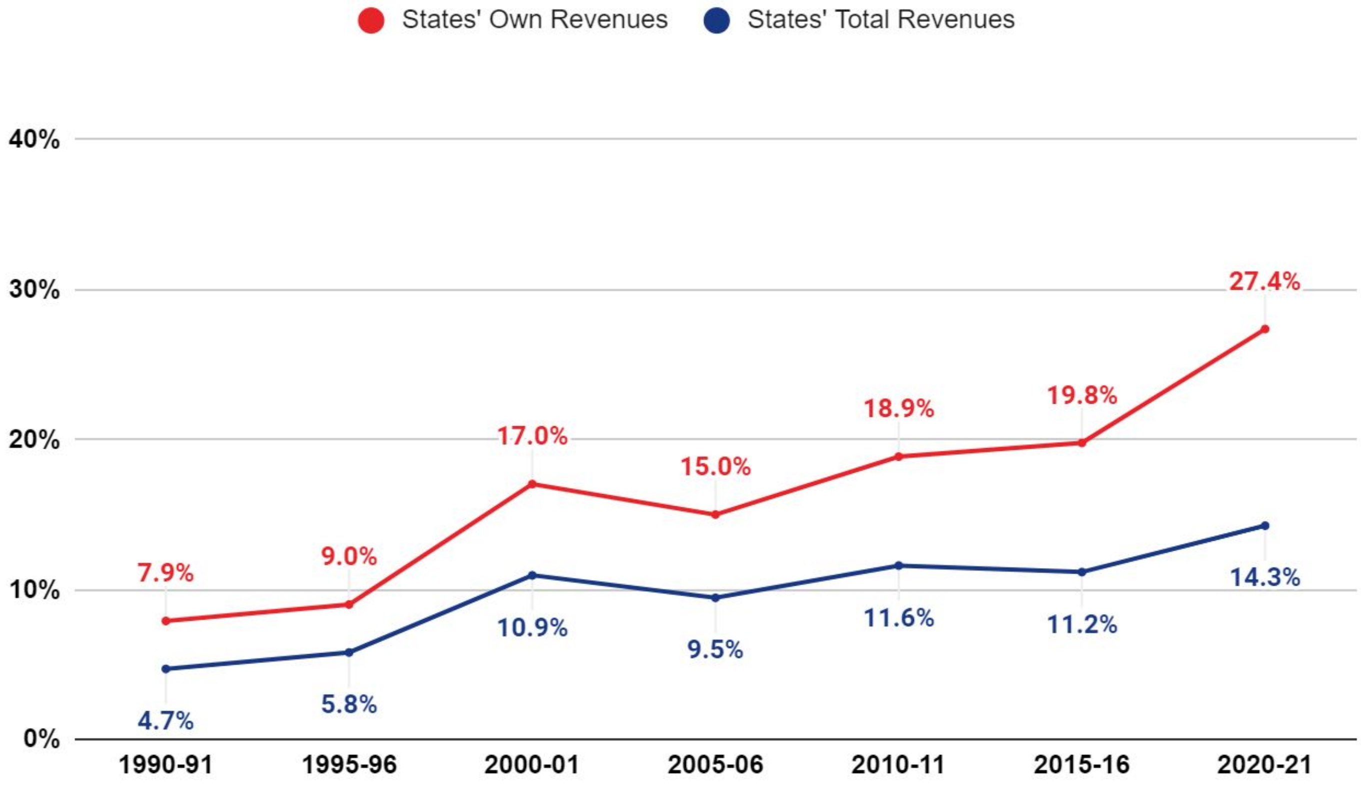



**Note:** Committed expenditure includes salaries & wages, pensions and interest payments. CSS: Centrally Sponsored Schemes

**Source:** Union Budget Documents

# Pension Burden depleting States' Revenues

## Pension Expenditure of All States as a Share of Revenues



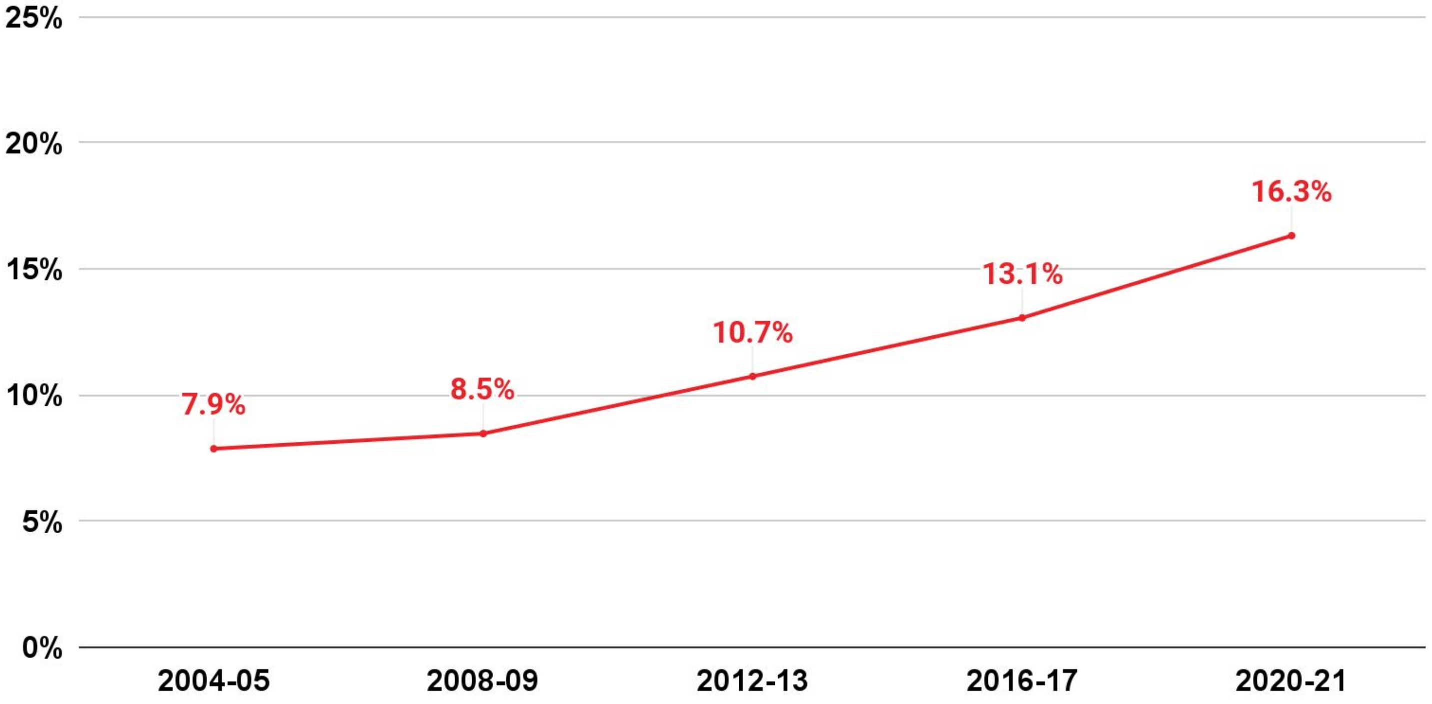

- Under the Old Pension Scheme (OPS), **pension constitutes both wage-indexed and price-indexed, open-ended liability.**
- The Compound Annual Growth Rate **(CAGR)** of **pensions** during the period 2004-05 to 2021-22 was **14.96%**, while the **States' own revenue** grew at a compound annual rate of **12.60%**.

**Note:** States' Total Revenues include Transfers from the Union Government.

**Source:** Preserving Growth Momentum, A Politically Viable Framework for Fiscal Prudence, *FDR*.

# Pension Burden depleting Union’s Revenues

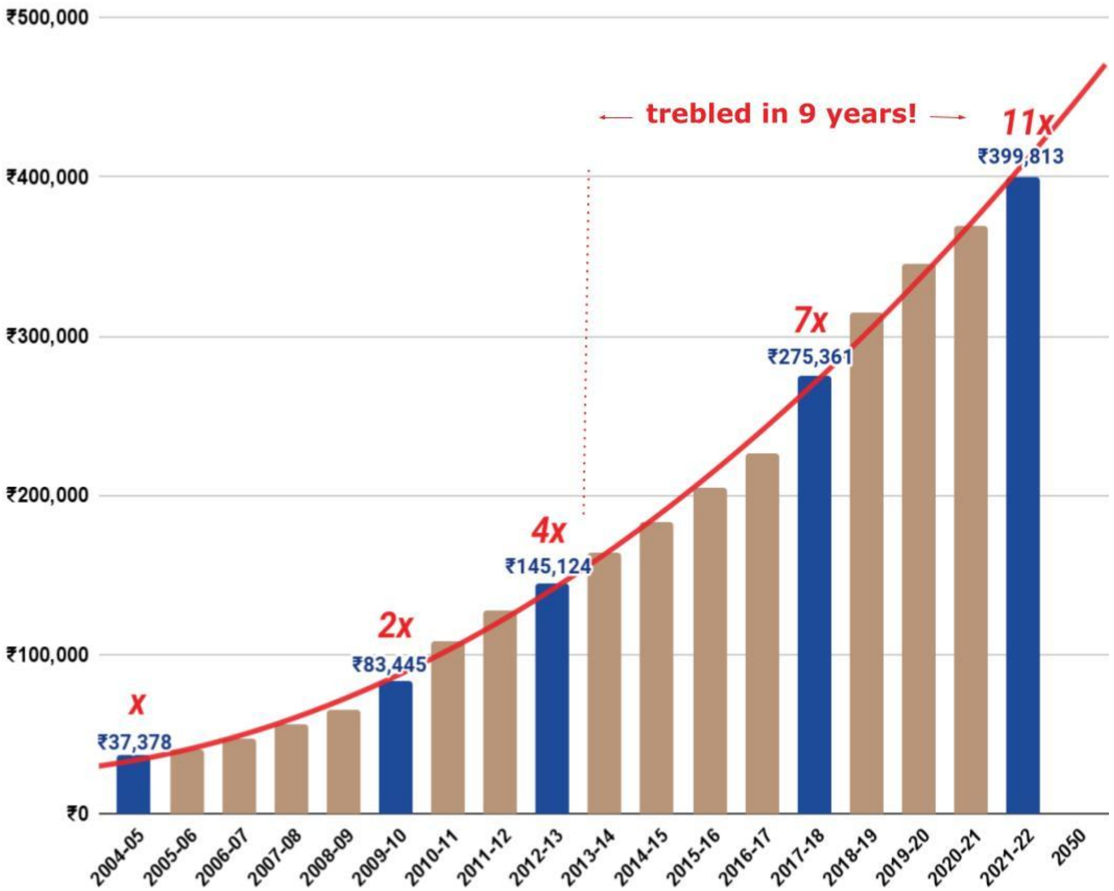
## Pension Expenditure of the Union as a Share of Revenue Receipts




**Note:** Union’s Revenue Receipts are net of transfers.

**Source:** C&AG Reports; Report of the Seventh Central Pay Commission; State Finances: A Study of Budgets 2022-23, RBI

# Mounting Pension Burden
## Pension Outgo of all States and UTs (in ₹ Crore)

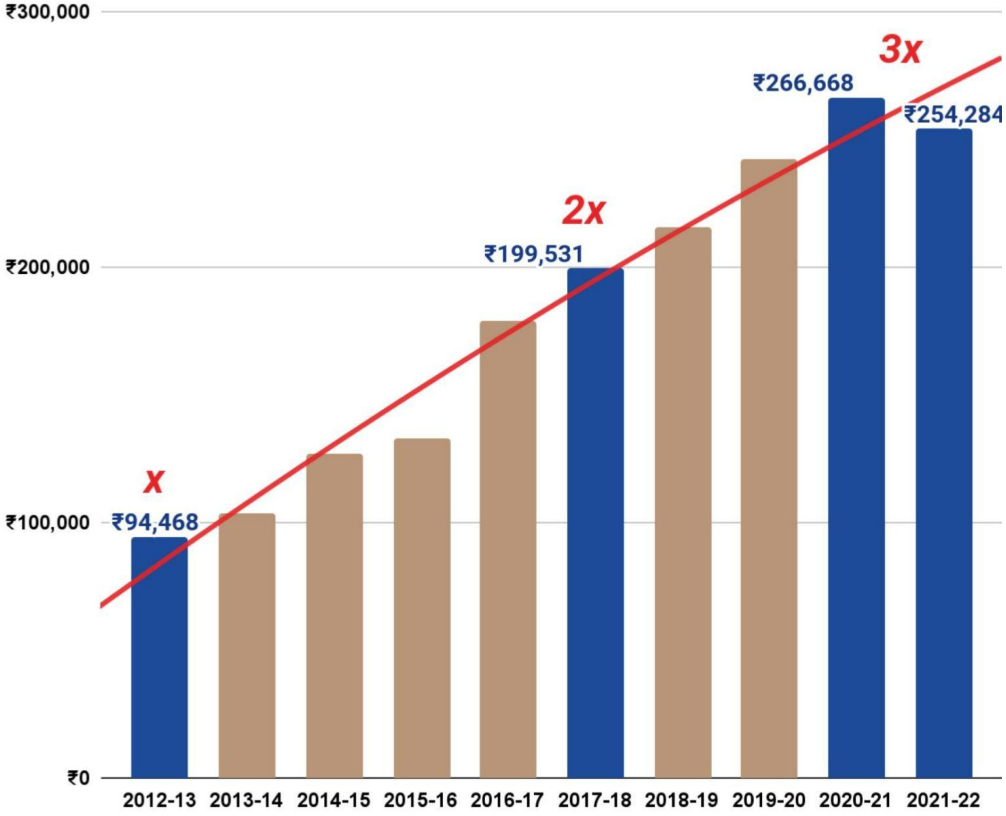



- The pension expenditure in States increased eleven times – from ₹37,378 crore in 2004-05 to ₹399,813 crore in 2021-22, and almost **trebled in nine years** – from ₹145,124 crore in 2012-13 to ₹399,813 crore

**Source:** Preserving Growth Momentum, A Politically Viable Framework for Fiscal Prudence, *FDR*.

# Mounting Pension Burden

## Pension Outgo of the Union Government (in ₹ Crore)




- The pension expenditure of the Union increased **three times in nine years** – from ₹94,468 crore in 2012-13 to ₹254,284 crore in 2021-22

**Source:** Preserving Growth Momentum, A Politically Viable Framework for Fiscal Prudence, *FDR.*

# Social Security Systems: The Global Norm vs. India

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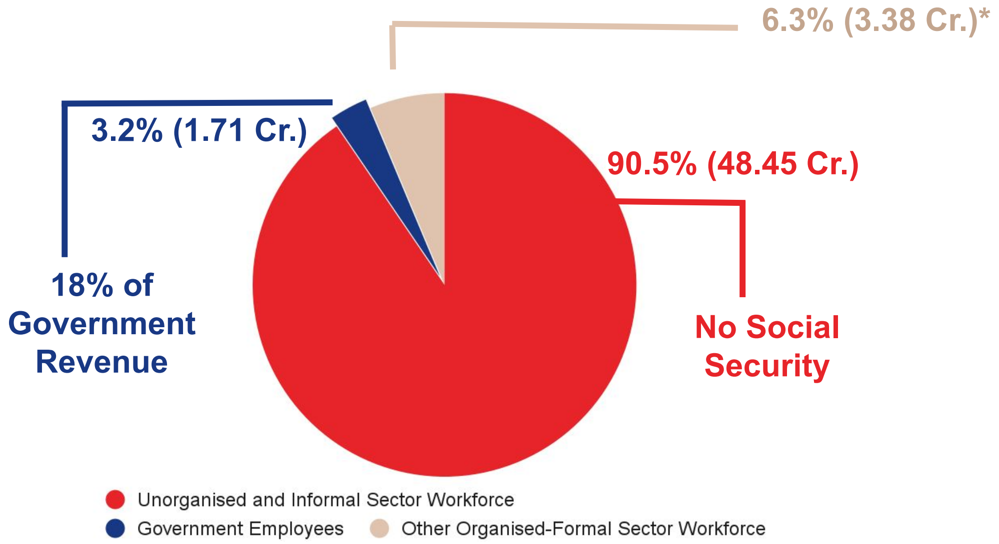
| Overview of Contributory Pensions Programmes in Select OECD Countries and Comparison with India | | | | |
|---|---|---|---|---|
| **Country** | **Name of the program** | **Nature of Pension Liability** | **Coverage as a share of Workforce** | **Pension Expenditure as a Share of General Government Revenues** |
| **United States (2021)** | Old Age, Survivors and Disability Insurance | Funded | 94% | 14.79% |
| **United Kingdom (2020)** | New State Pension | Funded | ~100% | 12.60% |
| **France (2021)** | Basic Scheme and Compulsory Complementary Scheme | Funded | ~100% | 22.70% |
| **Sweden (2020)** | Income Pension (Inkomstpension) | Funded | ~100% | 13.10% |
| **India (2021)** | Old Pension Scheme (OPS) | Unfunded | 1.84% | 18.20% |
| | National Pension System (NPS) | Funded | 1.36% | |

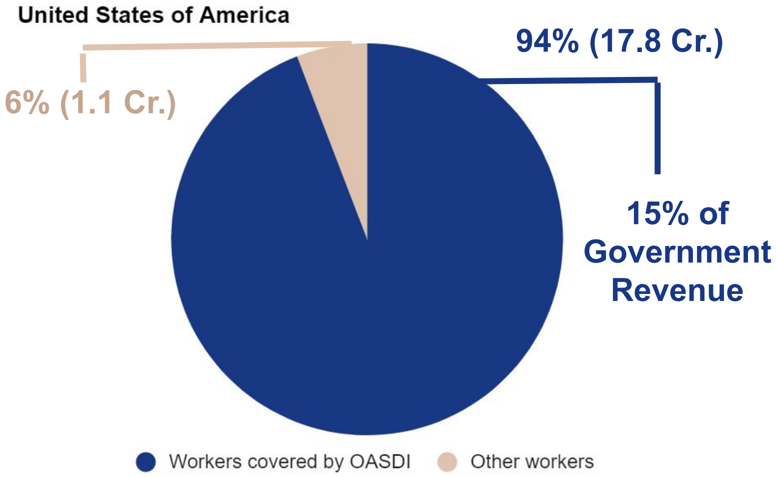
- Even the most developed countries with much higher tax-GDP ratios than India have adopted the system of contributory pensions.
- The annual contributions, under NPS, are taken from the period between June 30, 2022 and June 30, 2023. The Accumulated Reserves or Assets Under Management are as of June 30, 2023.

**Source:** Preserving Growth Momentum, A Politically Viable Framework for Fiscal Prudence, *FDR*.

# Comparing Pension Benefit – United States (Funded) vs. India (Unfunded)

## Workforce and Social Security Expenditure, India & USA




**Source:** Preserving Growth Momentum, A Politically Viable Framework for Fiscal Prudence, *Foundation for Democratic Reforms.*

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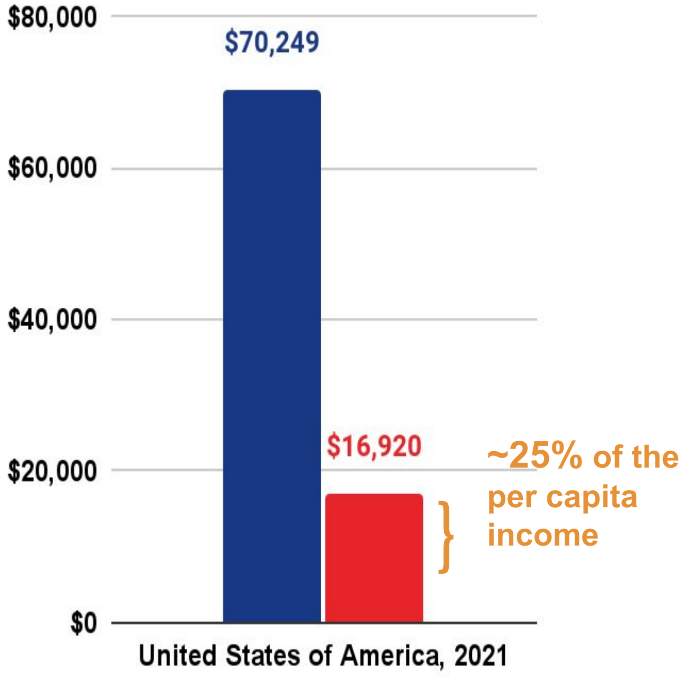
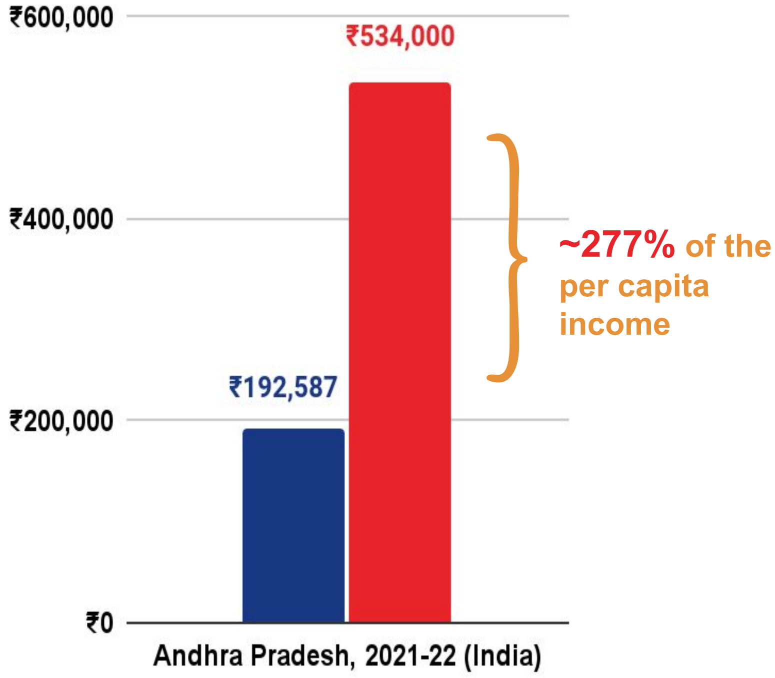


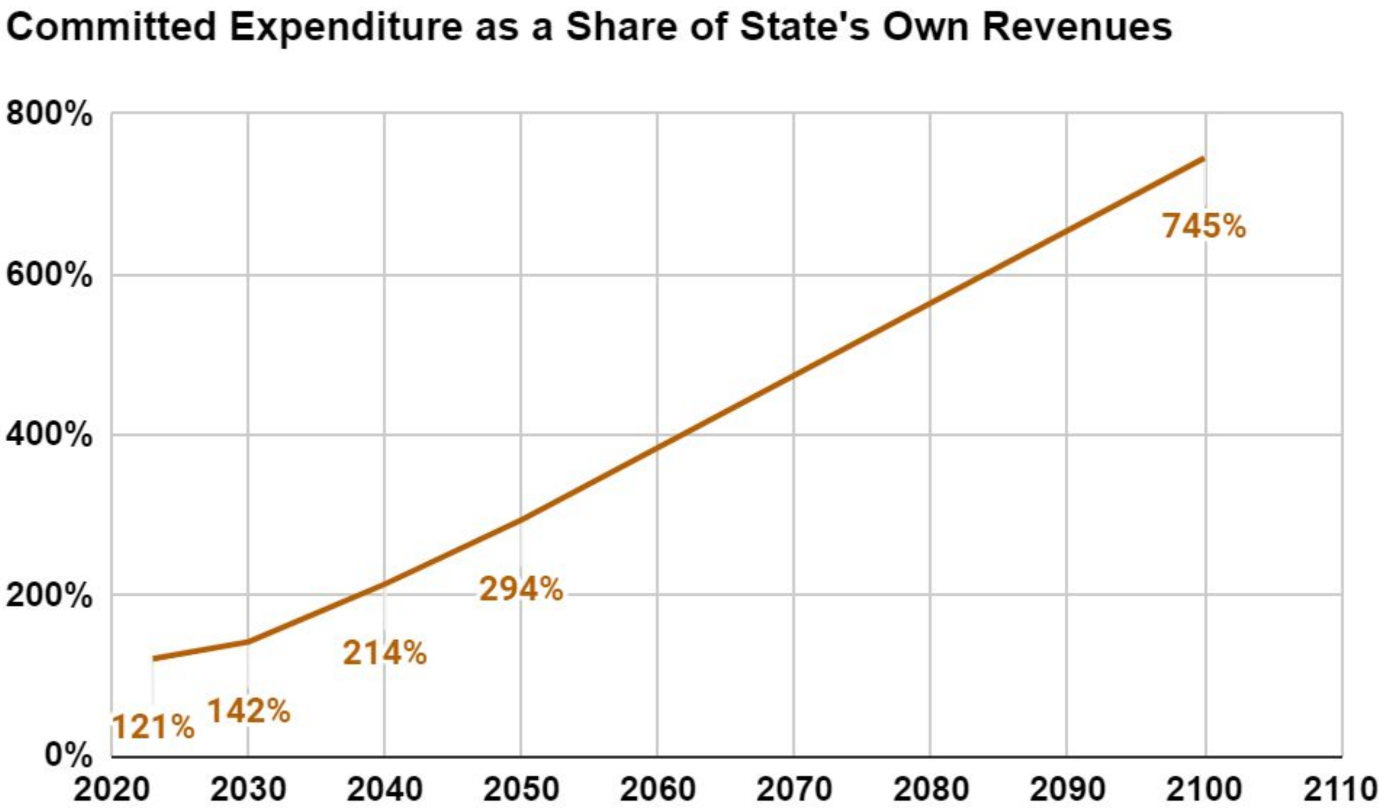




Annual per capita income

Average annual pension per beneficiary

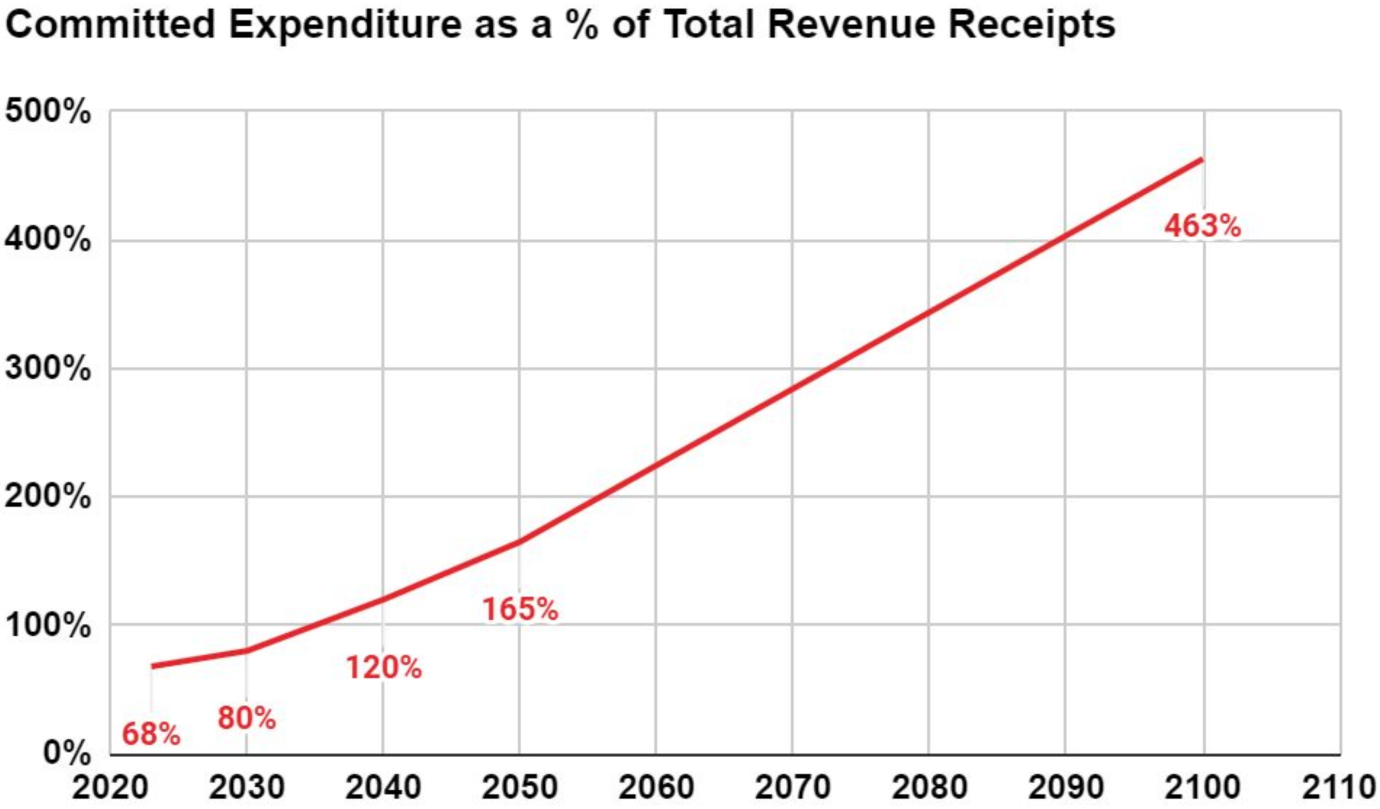
**Source:** Preserving Growth Momentum, A Politically Viable Framework for Fiscal Prudence, *Foundation for Democratic Reforms*

# Horrendous Price with OPS – Andhra Pradesh Projections



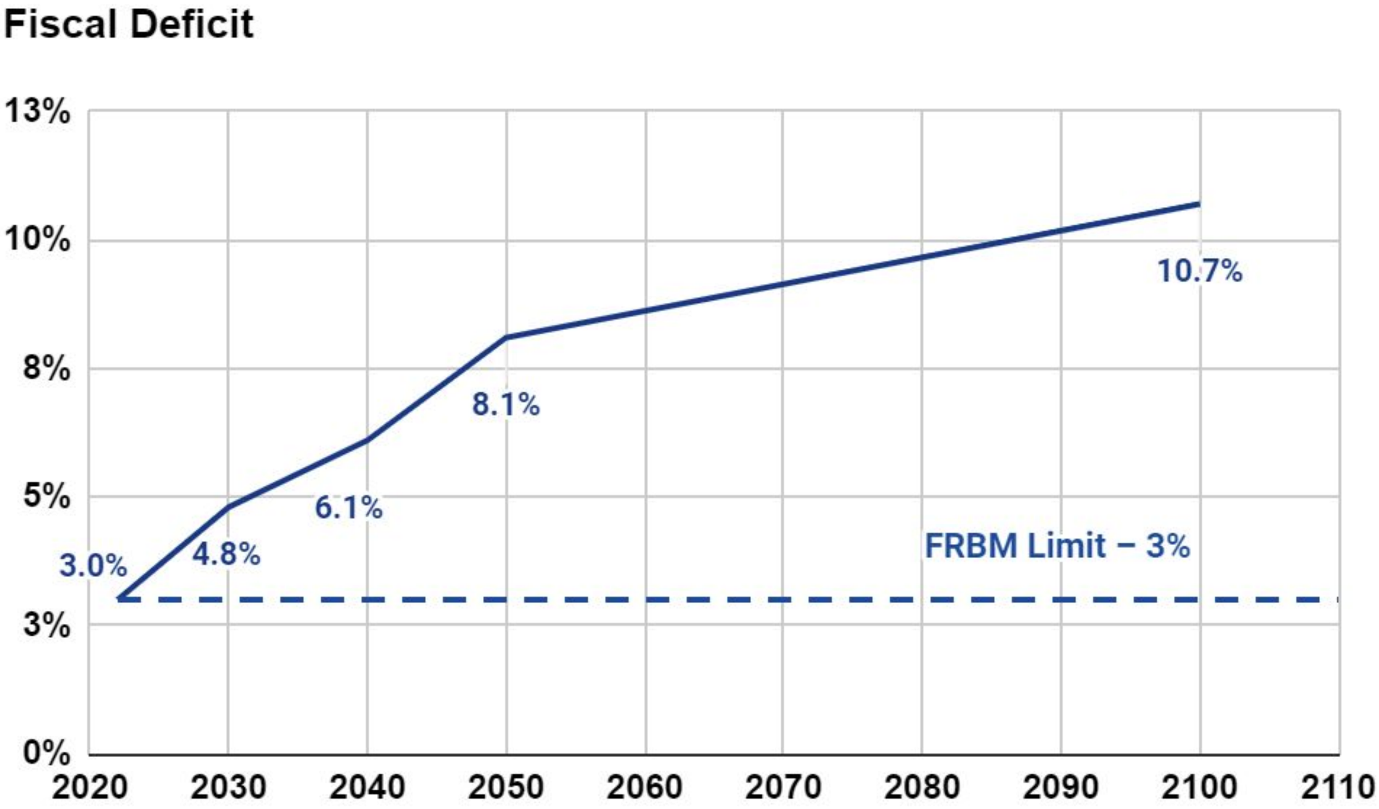

**Source:** Government of Andhra Pradesh Communication dated 5th October 2023.

# Horrendous Price with OPS – Andhra Pradesh Projections




**Note:** Calculated from the estimates shared by the Andhra Pradesh Government
**Source:** Government of Andhra Pradesh Communication dated 5th October 2023.

# Horrendous Price with OPS – Andhra Pradesh Projections




**Source:** Government of Andhra Pradesh Communication dated 5th October 2023.

# Horrendous Price with OPS – Andhra Pradesh Projections

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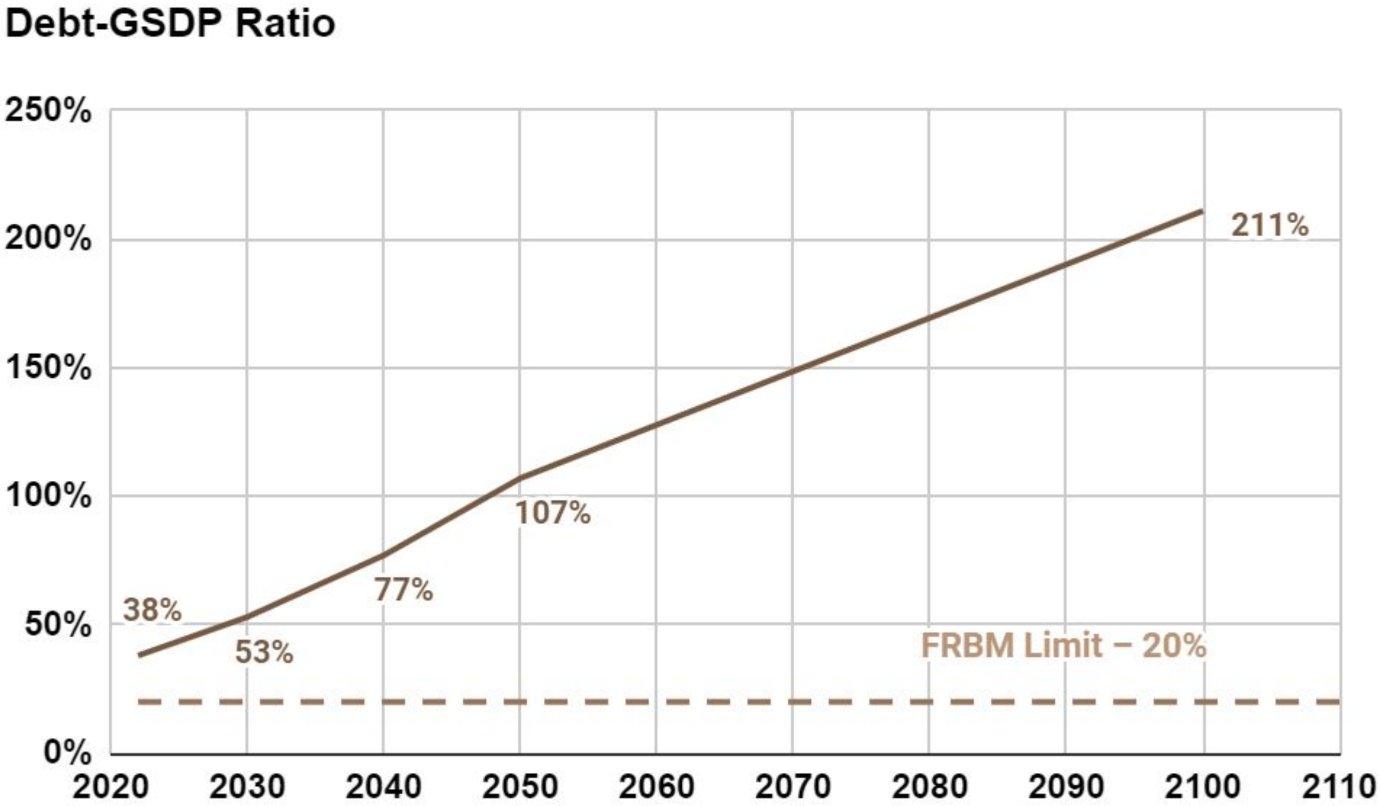


**Source:** Government of Andhra Pradesh Communication dated 5th October 2023.

# Fiscal Stability – Union is the Ultimate Guarantor of all Public Debt

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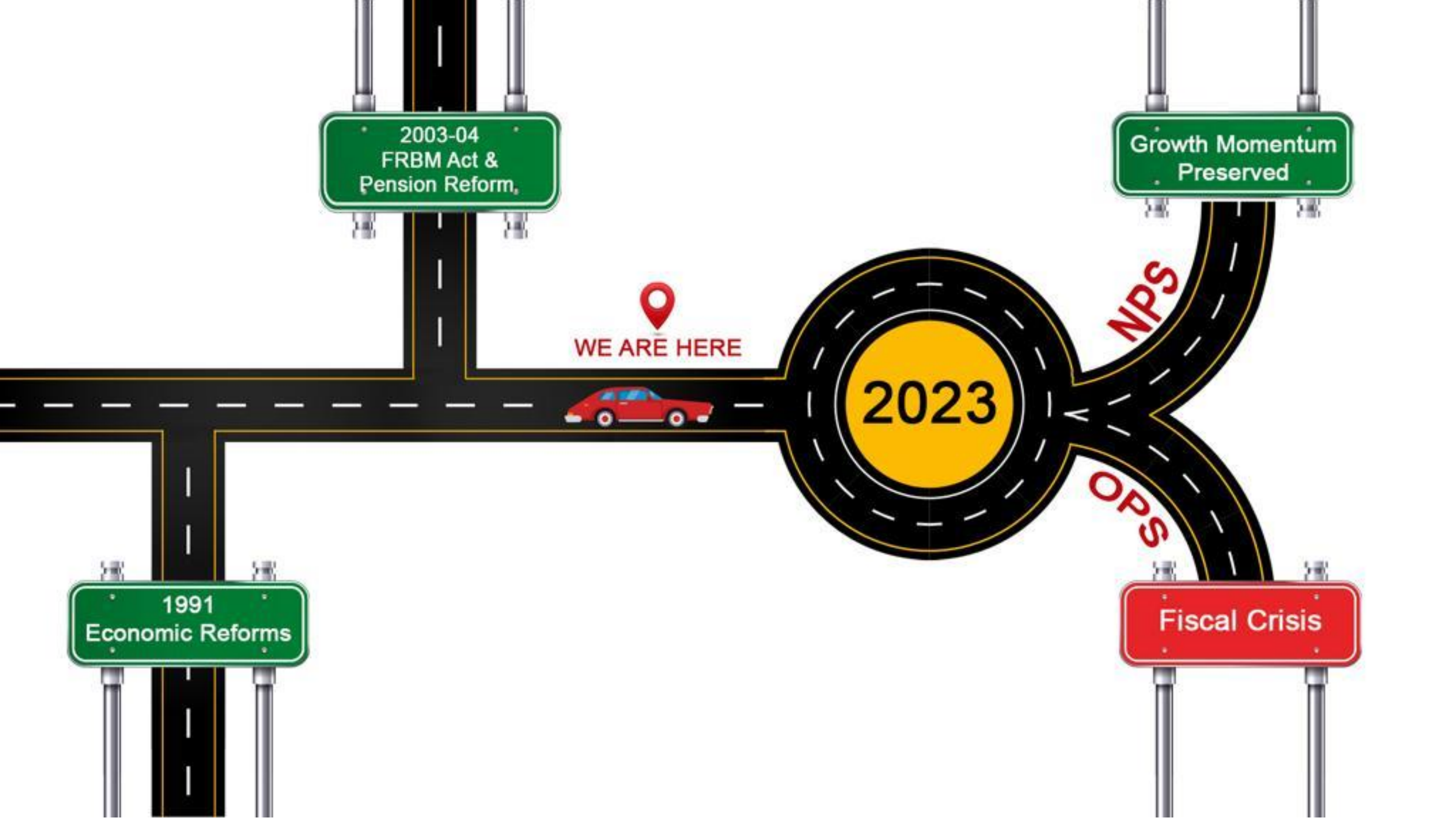
- The **fundamental principle** that informed the constitution-makers in determining relations between the Union and the States is that **India is one indivisible economic unit,** and that a threat to the financial stability of any part of the territory of India is a threat to the financial stability and credit of India.
  - The explicit powers of the Union under **Article 360** signifies that **Union is the guarantor of the financial stability and credit of India** across all tiers of government.
- The **Constitution does not envisage a State or a constituent unit of the Indian Union going bankrupt.**

## Excerpt from the Constituent Assembly Debates on Article 360 (or Article 280A in the Draft Constitution)

> *"…This article in the Constitution is the realisation of one supreme fact that the economic structure of the country is one and indivisible. If a province breaks financially, it will affect the finances of the Centre: if the Centre suffers, all the provinces will break. Therefore the interdependence of the provinces and the Centre is so great that the whole financial integrity of the country is one…"*


2003-04
FRBM Act &
Pension Reform
Growth Momentum
Preserved
WE ARE HERE
2023
NPS
OPS
1991
Economic Reforms
Fiscal Crisis

## Guiding Factors:

- Creating a framework acceptable across the society and political spectrum.
- Promoting a fair, transparent, and credible process in the management of public finances.
- Balancing sovereignty of elected governments with the principle of intergenerational equity.
- Extending the principles to both the Union and States, for broad-reaching impact.

# Moving forward: Framework for the National Roundtable

- The Roundtable will deliberate upon 3 prominent themes with several thematic sub-issues. The breakdown of the same has been illustrated below:

| Theme 1: Constitutional Mechanisms to safeguard Public Finances in a Federal Polity. |
|---|
| **Issue 1** - Is it sustainable to borrow in perpetuity for current expenditure without creating assets for the future? |
| **Issue 2** - What is the impact on inter-generational equity when the burden of deferred liabilities is passed onto future generations in a cash-accounting system? |
| **Issue 3** - What are the approaches available to institutionalize effective monitoring and oversight of public expenditure even as the autonomy of elected governments is respected? |
| **Issue 4** - What are the possible approaches to ensure independent, transparent, and non-partisan exercise of authority under Article 293(3)? |

# Moving forward: Framework for the National Roundtable

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## Theme 2: A sustainable Pension System for Government employees.

**Issue 5** - What mechanisms can be implemented to ensure that funding for pension commitments under a non-contributory, defined benefit pension plan is concurrent with the active service years of employees, including those in the defense force?

**Issue 6** - What viable approaches can be employed to strike a balance between the genuine social security needs of government employees and the long-term, sustainable health of Public Finances?

## Theme 3: A viable roadmap for Universal Social Security Coverage.

**Issue 7** - Exploring the design of a comprehensive social security system that initially covers the organized sector and gradually extends to the unorganized sector, encompassing the entire population.

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**“But it has always been difficult to interest politicians in reform because of the slow rate of social pay-off compared with the short-term political costs of change.”**

**Douglas Wass**