# Union Budget 2024: Amid global headwinds, there is no room for irrational expectations

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**LEKHA CHAKRABORTY**

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Against the backdrop of volatile stock markets and general elections, the upcoming Interim Budget 2024 is highly significant. The geopolitical uncertainties due to war, energy price volatility with Brent oil rise to $78.51 per barrel, **risks in the Red Sea** and using the longer trade route via Cape of Good Hope and associated delays in consignments, uncertainties in US Fed Reserve announcements in February are the major factors that have led to the present macroeconomic uncertainties and stock market volatility. The crucial question therefore is how to boost the investor's confidence and how to woo the calculus of consent of voters in the 2024 general elections. This twin task is beyond the purview of just an Interim Budget 2024.

Internally, India is in a transition towards a new fiscal policy imperative incorporating the challenges from Artificial Intelligence, climate crisis, war and uncertainty. The fear of less job opportunities, the risks of new digital financial infrastructure, and the existential climate crisis are real, and India contributed to these discussions relating to a multilateral regulatory framework in Davos, at the **World Economic Forum** this past week. Against this backdrop, the constrained optimisation strategy before the Finance Minister is to remain in the fiscal consolidation path towards an economic growth recovery.

## Fiscal Consolidation

The fiscal deficit target for FY25 in the midst of weaker nominal GDP growth and disinvestment shortfall will be below 6 percent, slightly around 5.2-5.5 per cent. This fiscal glide path is crucial to reach the 4.5 percent fiscal deficit to GDP by 2025-26. The Interim Budget will pitch a realistic projection for disinvestment proceeds. The fiscal marksmanship of disinvestment proceeds is always eroding the budget credibility. A firm focus on capex will continue to be there and will be a highlight of Interim **Budget 2024**.

The FY24 fiscal deficit to GDP ratio of 5.9 percent will be a tough call given the shortfall in disinvestment proceeds, and weak nominal economic growth and rising revenue expenditure, mainly subsidies. However the tax buoyancy is satisfactory in the sense there is higher tax and non-tax revenue collection above the fiscal projections. Therefore there is room at the top to remain in the fiscal consolidation path. Tax buoyancy rather than expenditure compression is an ideal path towards fiscal consolidation. The fiscal austerity measures in a prelude budget to general elections can be detrimental as people vote back a government analysing their policies in retrospect.

It is highly unlikely to have major tax side announcements in an Interim Budget. Taxation is not an ideal tool to ensure redistributive justice either. However, a few tax side announcements – especially offering a differential tax exemption limit for women, could be there to attract middle class women voters.

**Maintaining Budget Credibility**

The fiscal narrative of capex is crucial for sustaining the economic growth numbers. It should crowd in private investment with a lagged effect, of course not instantaneously. So continued focus on infrastructure – both physical and social infrastructure – is crucial. The continued focus of capex in defence, roads and railways is welcome. The states are also doing heavy lifting in terms of capital spending. Continued support to state governments through a fiscal transfer on capex is crucial. My hunch is the budget allocation for interest-free 50-year loans to the states will be maintained in the present budget.

The wider question of link between global headwinds and the budget arithmetic needs to be analysed. It affects central bank announcements on interest rates as well. The US Fed Reserve week will announce a hike in interest rates, which will make capital flighty and this will affect the forex reserves. These global headwinds will be the downside risks to fiscal arithmetic.

However the financing pattern of deficit in India is predominantly from internal borrowing. The risks from external financing of deficits is not there in India as the external debt financing is negligible. There is no rollover risk either as the debt maturity structure is long term. However, the RBI policies of interest rate management can affect debt servicing as the public debt management can get costlier with higher interest rates. The RBI has no go other than keeping high interest rates sticky, given the external challenges in terms of mounting inflation and capital outflows.

The fiscal rules can determine an effective fiscal consolidation path and it is high time towards a "formal" upward revision in fiscal deficit-GDP threshold, given the volatility in Centre-State financial relations. This has implications for public debt management while deciding the available fiscal space, especially when revenues are uncertain amidst a fragile geopolitical situation and disruptions in global supply chains. Continued food security measures for the poor are therefore crucial in times of war and crisis.

Ideally, the fiscal risks can be deciphered from the budget numbers in terms of four macro-fiscal parameters: (i) fiscal deficit to GDP ratio; (2) public debt to GDP; (3) revenue deficit if above zero and (4) interest payments to revenue receipts ratio. However, high public debt in times of war and macroeconomic crisis is substantiated by linking it to capex formation in the economy. There is no narrative that the public debt to GDP ratio has gone haywire during the Modi regime just because of its articulation of linking it to capex for growth recovery.

If the announcements related to social infrastructure are within the Public Financial Management (PFM) tools like gender budgeting and climate responsive budgeting the fear of clientele-based freebie announcements can also be preempted.

Budget credibility is all that is crucial when it comes to a pre-election Budget. Budget credibility is about the ability of governments to accurately forecast macro-fiscal variables. Announcing a Fiscal Council cannot be denied from that perspective, as a plausible institution which can monitor the Indian public finances in a sustainable manner.

***Lekha Chakraborty is Professor, NIPFP and Member, Board of Management, International Institute of Public Finance, Munich. Views are personal, and do not represent the stand of this publication.***