India’s central government was faced with a fiscal crisis even prior to the Covid-induced lockdown. Provisional estimates from the Controller General of Accounts of actual revenues collected in financial year 2019-20, or the fiscal year that ended March 2020, point to an erosion of revenue receipts of crisis proportions. As compared with the original budget estimate of Rs. 19.6 lakh crore, and a revised estimate (or late-in-year projection) of a lower Rs. 18.5 lakh crore, actual revenue receipts are currently placed at just Rs. 16.8 lakh crore. This implies that the actual figure is more than 14 per cent short of projections in the first budget of the second Modi government and 9 per cent short of the projection (revised estimates) for financial year 2019-20 in the Budget presented by Finance Minister Nirmala Sitharaman this February. The revenue shortfall has meant that the Centre’s revenue receipts grew by just 2.9 per cent in 2019-20 when compared with the previous fiscal year, which implies that real revenues (adjusted for inflation) have in fact fallen. This deceleration in revenue growth occurred in a year for which only about a week fell in the lockdown period, so that the serious revenue shortfall was a pre-Covid phenomenon and cannot be blamed on the sudden stop induced by the pandemic.

Given the government’s obsession with realizing unrealistic fiscal deficit targets, this compression of revenue growth has meant that the Centre’s dependence on exceptional transfers from the Reserve Bank of India and on receipts from the sale of public assets to meet even routine expenditures has increased significantly. When these ‘exceptional’ sources of receipts fall short of expectations, as happened in 2019-20, meeting even unambitious expenditure plans requires window dressing budgetary figures. On the ground, capital expenditures and welfare expenditures, including on health, would have fallen even relative woefully inadequate budgetary allocations.

Underlying this fiscal mess is the failure to mobilise adequate resources through taxation at a time when the need is for substantial additional resource mobilisation. A casualty of the business-friendly taxation stance of the NDA government has been a substantial loss of buoyancy with respect to direct tax generation, with tax revenues falling despite the low levels of Centre’s direct tax to GDP ratio and rising income inequality in the country. Net direct tax collection, or gross direct taxes adjusted for tax refunds, declined in nominal terms from Rs. 11.36 lakh crore in 2018-19 to Rs 10.49 lakh crore in 2019-20, or by close to 8 per cent. The factor dominantly responsible for this decline was the decision, in the midst of a demand recession, to seek to stimulate the economy with corporate tax concessions announced in September 2019.

That ‘stimulus’ took the form of a huge reduction in the corporate tax rate from 30 per cent (or an effective rate of 34.61 per cent after surcharge and cess) to 22 per cent (or an effective rate of 25.17 per cent) for domestic companies that do not avail of tax incentives or exemptions. New domestic manufacturing companies incorporated on or after October 1, 2019 will pay corporation tax at the reduced rate of 15 per cent (which is an effective rate of 17.01 per cent) so long as they do not avail of incentives and exemptions. And the minimum alternative tax (MAT) applicable to companies that do avail of incentives and exemptions has been reduced from 18.5 per cent to 15
per cent. This is a huge bonanza, which dominantly explains the contraction in direct tax revenues.

The second contributor to the compression in tax revenues is the limited buoyancy of indirect tax revenues garnered through the Centre from Goods and Services Tax (GST) imposts. In fact, in four of 12 months, central revenues from GST in 2019-20 were lower than the sum collected during the corresponding months of the previous year. Overall, the Centre’s revenues from GST rose by 8 per cent in 2019-20, despite the lower than projected base level in 2018-19. To recall, the government had promised states a 14 per cent annual increase in revenues from a base level GST estimate, failing which they were to be compensated with collections from a special cess. This suggests that, at the minimum, the Centre too would have expected a 14 per cent growth in GST revenues. The 8 per cent realised in 2019-20 is, therefore, way short of expected revenue growth. The GST regime was launched in July 2017. So, the argument that teething troubles and initial glitches in implementation of a new “game changing” measure are responsible for shortfalls in GST receipts no longer apply. Clearly, the GST regime has proved a failure, even while it has substantially curtailed the limited space that was available for states to increase their “own tax revenues”, in pursuit of an unrealisable “one nation, one tax” goal. That failure is now haunting the Centre as well, besides severely damaging the fiscal position of the state governments.

The poor performance with respect to corporate tax revenue generation and generation of revenues from GST, which is a second-best adaptation of value added taxation within a federal polity, is a fall-out of the shift to a neoliberal policy regime. A defining feature of such a regime is a lenient corporate tax structure, ostensibly aimed at incentivizing private investors and unleashing the animal spirits they are presumed to possess. That also explains why when a demand recession is dampening investment and curtailing growth, the government decides not to spend to revive demand, but hand over money to the corporate sector with tax concessions, which firms will not divert to investment in depressed market conditions.

The GST too is a neoliberal measure. The United States had a role to play in the spread of VAT. The Shoup mission to occupied Japan after World War II argued for its introduction. Subsequently the USAID promoted VAT and sought to popularize the system through financial and technical assistance to developing countries. All through that period, the US government was unwilling to implement the system at home. Later the World Bank and the IMF played a role in pushing the system. More than half the countries that introduced VAT in the 20 years starting 1991 did so on the basis of advice and assistance from the IMF’s Fiscal Affairs Department. Thus, the spread of VAT does seem to have a lot to do with the transition to market fundamentalism and market-friendly polices starting in the 1980s.

This is understandable. A neoliberal strategy substantially reduces taxes on trade. It also requires incentivizing the private sector with light touch taxation of higher incomes and corporate and financial profits. It also emphasizes the need for financial consolidation and reining in public debt. All of this necessitates reliance on forms of indirect taxation other than taxes on trade to sustain expenditure, however much curtailed. The nature of VAT helps in such a context. As an indirect tax VAT is not directly levied on the buyer and the legal liability is that of the producer, so it is less visible. Moreover, since VAT is imposed at each stage of the production process, it
gets incorporated into costs so that the final consumer would only note the tax paid on
value added at the final stage. This helps to legitimize a shift from progressive direct
taxation, especially corporate and income taxes, to regressive indirect taxation. All of
this favours a shift to VAT under neoliberal regimes, which partly explains its history.
It implicitly serves as one more instrument to redistribute incomes from ordinary
citizens, including the poor, to the very rich. The problem in India, however, is that
the GST version of VAT does not work well.

Once these neoliberal shifts on the taxation front begin to adversely affect
government revenues, within a neoliberal fiscal framework of caps on fiscal deficits
or spending financed with borrowing, a corollary is sluggish government spending
and lower growth. This had begun to manifest itself in India since 2016, with growth
in pre-Covid lockdown year 2019-20 now estimated at 4.2 per cent, the lowest since
the new GDP series was launched. That sets up a feedback loop, with low revenues
which curtails government spending reducing growth which then reduces revenues
further, for any given level of fiscal buoyancy, or responsiveness of revenues growth
to income growth. Revenue growth shrinks both because neoliberal fiscal reform
reduces fiscal buoyancy and because growth itself begins to fall.

These trends have other external effects. Neoliberal governments seek to address
sluggish revenue growth with the short-sighted measure of selling profitable, revenue
earning public assets to obtain what are euphemistically termed “non-debt creating
capital receipts”. As the fiscal crisis intensifies, the dependence on privatization
receipts increases. The central government pursued that trajectory successfully in
2018-19 when as compared with budgeted receipts of Rs. 80,000 crore from
privatization, the government actually managed to mobilise close to Rs. 95,000 crore,
hawking profitable assets and riding on a buoyant stock market. But as growth falters,
so does investor enthusiasm for public equity or the firms themselves. In 2019-20, the
government had hiked the budgeted receipts from privatization to Rs. 1,05,000 crore.
But as the economy slowed it managed to mobilise only a little more than Rs. 50,000
crore.

The picture is now clear. As the government gave up its role as development leader
within a neoliberal growth strategy, growth rode on a credit bubble. With that bubble
going bust and precipitating non-performing assets in the banking system, the credit-
led boom gave way to a slowdown. The neoliberal fiscal response curtailed
government revenues and expenditures further. Growth fell sharply and so did
revenues. In the event, the government is trapped in a fiscal crisis and the economy is
in low level disequilibrium.

* This article was originally published in the Frontline Print edition: July 3, 2020.