

# Efficient and Equitable Fiscal Consolidation: Illustration for India

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Colombo, Sri Lanka  
July 14, 2016



## Focus of Presentation



- Although fiscal consolidation may be needed to restore fiscal sustainability and promote economic growth, it can have adverse impacts on poverty and income inequality in the absence of mitigating fiscal measures
- Have seen earlier that design of fiscal redistribution should
  - Be consistent with macroeconomic and fiscal sustainability
  - Take into account the combined impact of tax and spending reforms on efficiency and equity
  - Reflect the administrative capacity that exists in a country
- Fiscal consolidation can help achieve both efficiency and equity objectives if it involves
  - Structural tax reforms (efficient energy pricing, “sin” taxes, progressive income taxation)
  - Structural expenditure reforms (better targeting, conditionality)



- I. Indian context**
- II. Fiscal developments**
- III. Fuel pricing**
- IV. Design of efficient and equitable fiscal consolidation**
- V. Summary and key messages**



## **I. Indian Context**



- Need for fiscal consolidation is a recurring theme in India, along with focus on growth & poverty reduction
- Paper is intended to illustrate how fiscal consolidation can be designed to be consistent with growth and poverty alleviation objectives
  - Reform of energy subsidies
  - Increase in “sin taxes” on alcohol and tobacco
  - Redirect some of fiscal gains to expanding (reforming) key social programs
- Analysis is *illustrative* and abstracts from a number of important policy issues
  - Distinction between central and state taxation
  - More recent reforms of energy subsidies and social programs

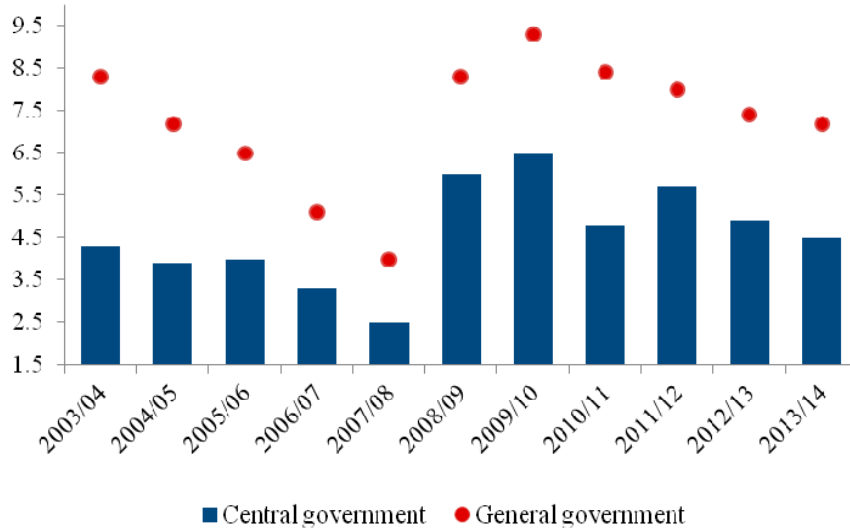


## II. Fiscal Developments in India

# Central deficit decreased but still higher than the 3 percent target



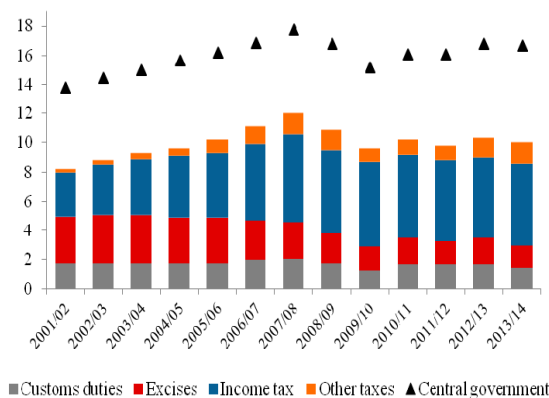
**Evolution of Fiscal Deficits in India, 2003–14**  
(Percent of GDP)



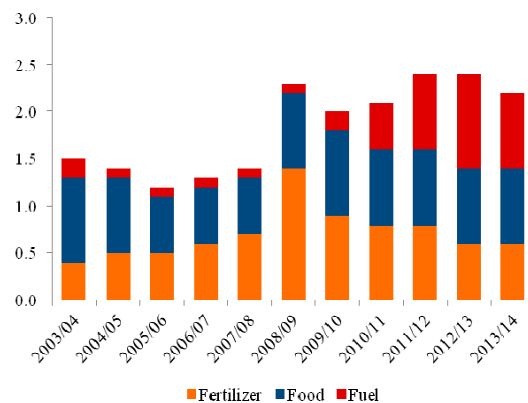
# Low level of taxes and increasing subsidies



**Evolution of Tax Revenues**  
(Percent of GDP)



**Expenditures on Subsidies**  
(Percent of GDP)



### III. Fuel Pricing in India

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#### Recent Fuel Price Reforms

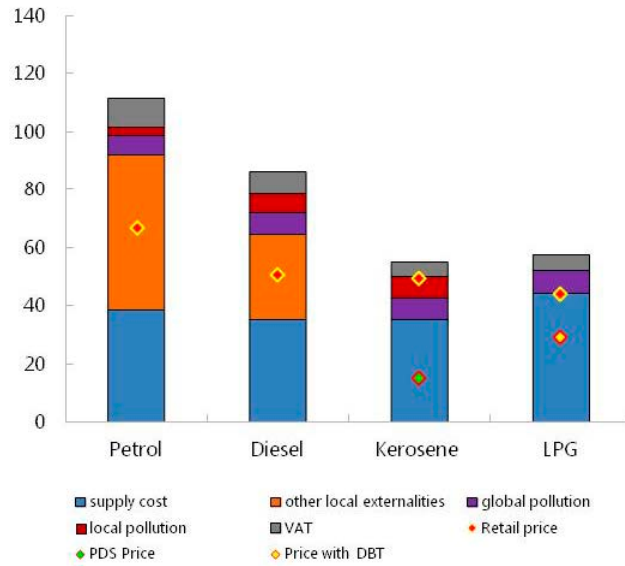
- **Gasoline:** prices liberalized since May 2010
- **Diesel:** prices liberalized since October 2014
- **Kerosene:** heavily subsidized – ongoing debate on replacing subsidies with targeted cash transfers
- **LPG:** subsidy replaced by nationwide Direct Benefit Transfer (DBT) Scheme PAHAL

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## Efficient pricing

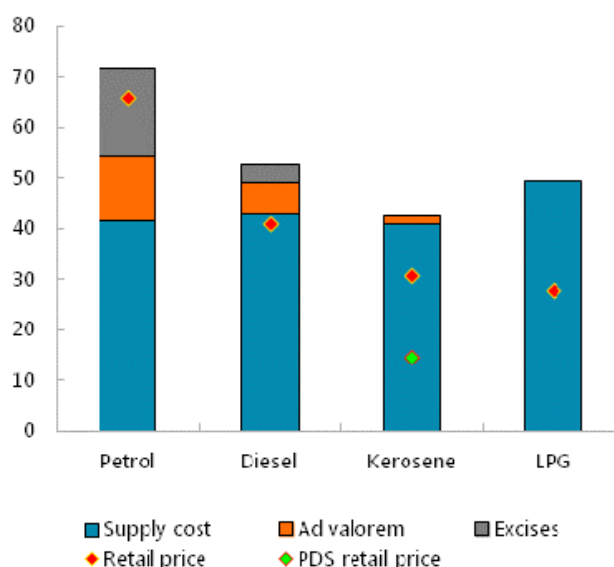
(In rupees per liter, kg, as of June 2015)



## IV. Efficient and Equitable Fiscal Consolidation

### Formula price

(In rupees per liter, kg, as of 2011/12)



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## Simulated tax and spending reforms

- **Tax reforms include**
  - Removing fuel subsidies as of 2011/12: gasoline (8 percent), diesel (29 percent), LPG (70 percent), PDS/market kerosene (181/35 percent)
  - Alcohol and tobacco (10 percent each)
- **Social transfer reforms include**
  - Scaling-up of existing benefits for PDS food subsidies (10-20 percent) and MGNREGA public works (75 days/year)
  - Reforming social safety net to improve targeting
- **Impacts simulated using household survey and input-output data for 2011/12**

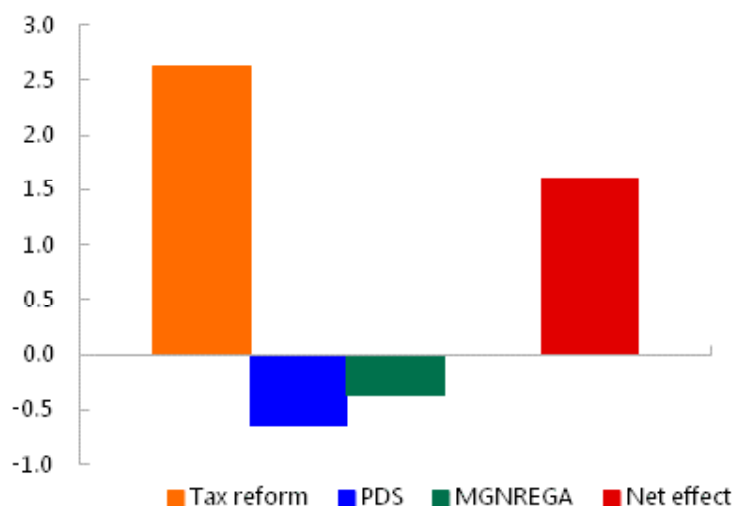
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# Fiscal implications of tax-transfer reforms



## Net Fiscal Impact of Tax-Transfer Reforms

(Percent of GDP)

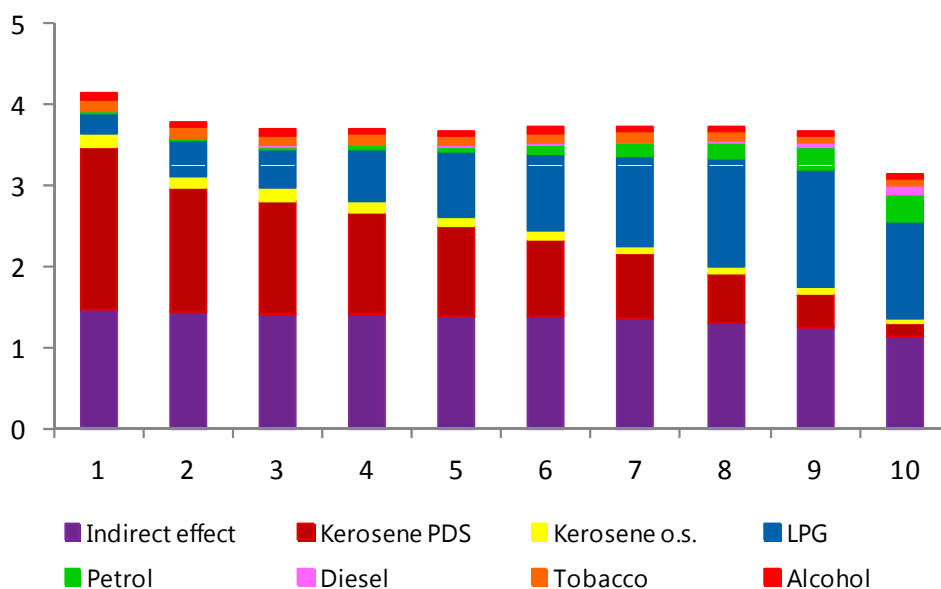


## Impact of tax reform is broadly similar across income groups but driven by different products



## Impact of tax reform by income group and product

(Percent of household consumption)

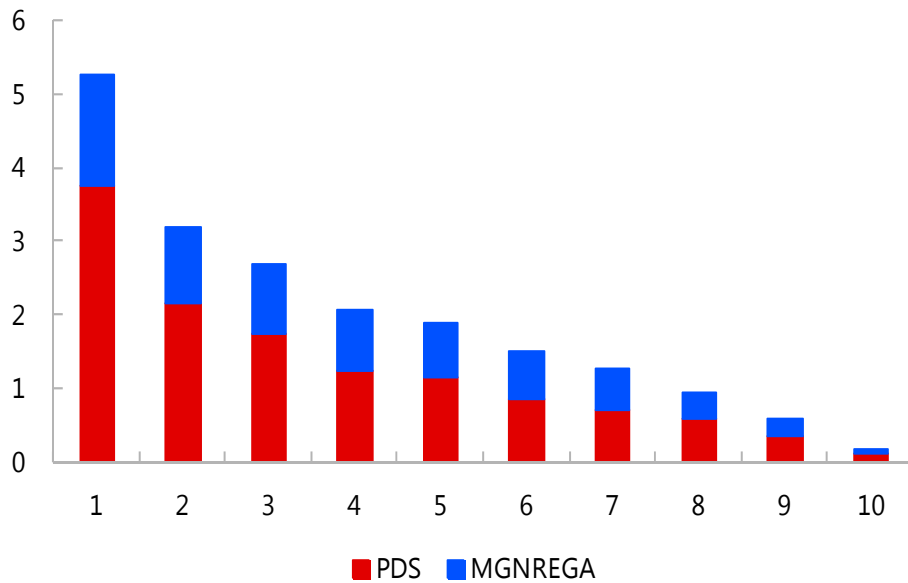




# Scaling-up transfer programs is progressive but has also significant leakage to higher income groups

**Impact of scaling-up transfers by income group and program**

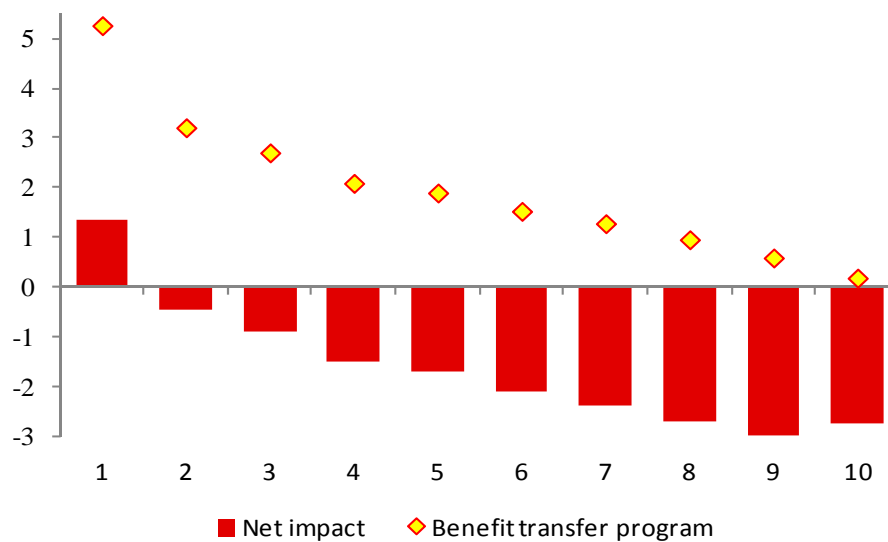
*(Percent of household consumption)*



# The net tax-transfer impact is progressive but lower income groups still lose

**Net Impact of tax-transfer reform by income group**

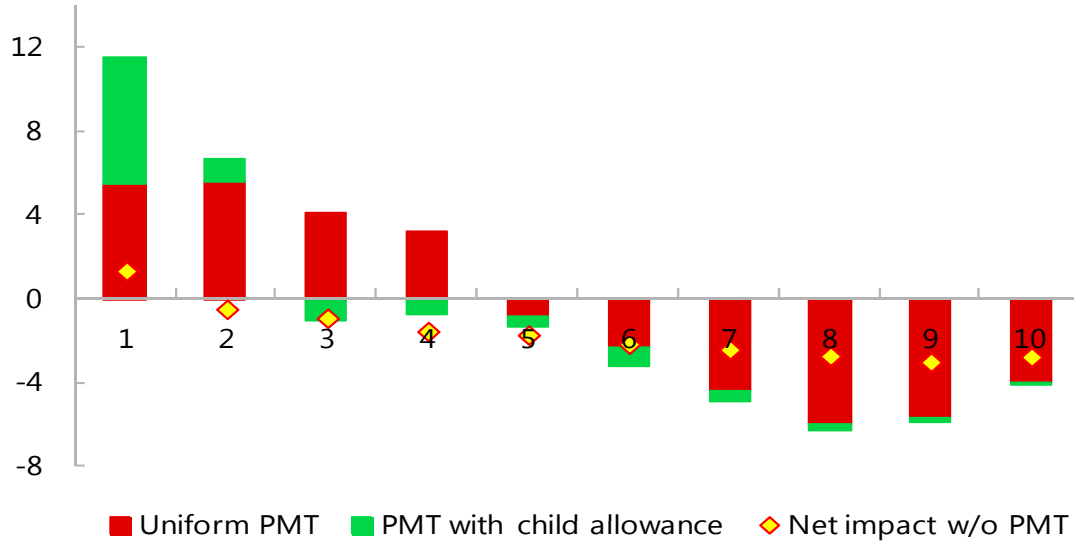
*(Percent of household consumption)*



# Impact on lower-income groups can be substantially improved through better targeting



**Net Impact of Tax Reform, Proxy Means Targeting and Cash Transfer**  
*(Percent of household consumption)*



## V. Summary and key messages

## Summary and key messages



- Focus is on how fiscal consolidation can be designed to be both efficient and equitable
- Reforms create additional fiscal space to reduce deficit and finance key spending priorities (investment, education, health)
- Redirecting some of the fiscal space to expand social safety net can mitigate impact on the poor
- Enhancing the cost-effectiveness of the social safety net (better targeting and coverage) can actually help to achieve fiscal consolidation objectives AND reinforce poverty reduction objectives

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**Thank you!**



***“The Quest for the Holy Grail: Efficient and Equitable Fiscal Consolidation in India”***

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