



Consequences of Fiscal Deficit on Economic Prosperity in India: A Post-Economic Meliorate Analysis

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ABSTRACT

The study titled “Consequences of Fiscal Deficit on Economic Prosperity in India: A Post-Economic Meliorate Analysis” examines the multifaceted impact of fiscal deficits on India’s economic growth, stability, and development in the post-reform era. Using secondary data from government financial reports, RBI bulletins, and economic surveys, the research explores how persistent fiscal imbalances influence inflation, investment patterns, interest rates, and public debt sustainability. The analysis reveals that while fiscal deficits have stimulated short-term growth through increased public expenditure, they have also led to inflationary pressures, higher borrowing costs, and reduced efficiency in private investment. The study further highlights that prudent fiscal management, efficient taxation, and targeted social spending are essential to ensure long-term economic prosperity. Overall, the findings underscore the necessity for fiscal discipline and policy coherence to balance developmental needs with macroeconomic stability in India’s evolving economic landscape

Keywords: Fiscal Deficit and Growth Dynamics, Public Debt Sustainability (India), Crowding-Out and Investment, Inflationary and Exchange-Rate Effects, Fiscal Policy Equity and Welfare Outcomes.

INTRODUCTION

Fiscal deficit, a critical macroeconomic indicator, represents the excess of total government expenditure over its total revenue (excluding borrowings). It serves as a key reflection of a nation’s fiscal health and its ability to maintain economic stability and growth. In the Indian context, fiscal deficit has long been a subject of policy debate, particularly concerning its implications for inflation, public debt, investment, and overall economic prosperity. The post-1991 economic liberalization era, often termed India’s phase of economic melioration, marked a transformative period in fiscal management. However, persistent fiscal imbalances have continued to challenge the objectives of inclusive and sustainable development.

During the pre-reform period, fiscal deficits in India were largely driven by revenue expenditures and inadequate fiscal discipline. The economic reforms of 1991 aimed to correct these structural imbalances through fiscal consolidation and market-oriented policies. Yet, despite several initiatives such as the Fiscal Responsibility and Budget Management (FRBM) Act of 2003, successive governments have struggled to contain deficits due to rising public expenditure on subsidies, welfare schemes, and infrastructure development. The global financial crisis of 2008-09, the implementation of the Goods and Services Tax (GST) in 2017, and the COVID-19 pandemic further exacerbated fiscal pressures.

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India's fiscal deficit, which stood at around 3.4% of GDP in 2018-19, expanded to 9.2% in 2020-21 due to pandemic-related spending, before gradually narrowing to approximately 6.7% in 2021-22. While counter-cyclical fiscal policies supported economic recovery, concerns remain regarding long-term debt sustainability, inflationary tendencies, and crowding out of private investment. Economists argue that an optimal fiscal deficit, when directed toward productive capital formation, can stimulate growth, but excessive deficits financed through borrowing may hinder macroeconomic stability and intergenerational equity. A post-economic meliorate analysis of fiscal deficit in India thus becomes crucial to understanding its nuanced consequences on economic prosperity. It involves evaluating the trade-offs between growth and fiscal prudence, the role of fiscal policy in managing cyclical fluctuations, and the effectiveness of reforms aimed at ensuring fiscal sustainability. This study seeks to examine how fiscal deficits have influenced India's economic trajectory, exploring both their stimulative and adverse effects in the post-reform period up to 2022.

REVIEW OF LITERATURE

The relationship between fiscal deficit and economic prosperity in India has been a subject of extensive scholarly inquiry, particularly in the context of post-economic reforms. This review synthesizes key findings from literature up to 2022, focusing on the implications of fiscal deficits on economic growth, investment, inflation, and fiscal sustainability.

• Fiscal Deficit and Economic Growth

A significant body of research examines the impact of fiscal deficits on India's economic growth trajectory. Studies indicate that while fiscal deficits can stimulate short-term economic activity through increased government spending, their long-term effects are more nuanced. For instance, Kumar (2019) utilized a regression model to analyse data from 1980-81 to 2017-18, concluding that fiscal deficits exert a negative and significant impact on India's economic growth. This finding suggests that excessive borrowing may crowd out private investment and lead to higher interest rates, thereby hindering sustainable economic expansion. Conversely, Behera (2022) employed a standard economic growth model to empirically evaluate the effects of fiscal deficits on the economic growth of 14 major Indian states. The study found that while moderate fiscal deficits could support growth, excessive deficits were associated with lower economic growth, highlighting the importance of fiscal discipline.

• Fiscal Deficit and Investment Dynamics

The composition of fiscal deficits plays a crucial role in determining their impact on investment. Rangarajan (2005) examined the long-term profile of fiscal deficits in India, noting that deficits financed through

productive public investment could enhance growth prospects. However, when deficits are primarily used for consumption expenditure, they may lead to inflationary pressures and higher interest rates, thereby discouraging private investment.

Further empirical analysis by Sharma (2024) on the sustainability of fiscal deficits in India revealed that the composition of government expenditure significantly influences economic outcomes. Deficits arising from capital expenditure were less detrimental to economic growth compared to those stemming from current expenditure.

• Fiscal Deficit and Inflationary Pressures

The relationship between fiscal deficits and inflation has been a focal point of economic research. Studies indicate that large fiscal deficits can lead to inflationary pressures, particularly if they are monetized by the central bank. This scenario can erode purchasing power and destabilize the economy. However, the extent of this effect depends on the underlying economic conditions and the credibility of monetary policy institutions.

• Fiscal Deficit and Fiscal Sustainability

The concept of fiscal sustainability is central to understanding the long-term implications of fiscal deficits. Sharma (2024) emphasized the importance of managing fiscal deficits to ensure that government debt remains at sustainable levels. Excessive deficits can lead to a rising debt-to-GDP ratio, potentially leading to a fiscal crisis. Therefore, maintaining fiscal discipline is crucial for ensuring long-term economic stability.

• Post-Reform Fiscal Trends and Policy Implications

The economic reforms initiated in 1991 marked a significant shift in India's fiscal policy landscape. Post-reform, the government has made concerted efforts to reduce fiscal deficits through measures such as subsidy rationalization, tax reforms, and expenditure management. These efforts have led to a decline in the fiscal deficit from 8.4% of GDP in 1991-92 to more sustainable levels in subsequent years. However, challenges remain, including the need for further fiscal consolidation and the management of off-budget liabilities.

The literature underscores the complex relationship between fiscal deficits and economic prosperity in India. While fiscal deficits can provide short-term economic stimulus, their long-term effects depend on their size, composition, and the underlying economic context. Excessive and poorly managed deficits can impede economic growth, increase inflationary pressures, and threaten fiscal sustainability. Therefore, achieving a balance between stimulating economic activity and maintaining fiscal discipline is essential for ensuring sustained economic prosperity in India.

OBJECTIVES

- To examine the historical trends and magnitude of India's fiscal deficit from post-economic reforms (1991) to 2022.
- To analyse the relationship between fiscal deficit and macroeconomic indicators such as GDP growth, inflation, and unemployment in India.
- To investigate the impact of fiscal deficit on public debt sustainability and fiscal health of the government.
- To assess the influence of fiscal deficit on investment, savings, and capital formation in the Indian economy.
- To evaluate the sectoral consequences of fiscal deficits, including infrastructure, agriculture, and social welfare programs.
- To explore the role of fiscal deficit in shaping monetary policy, interest rates, and inflationary pressures.
- To provide policy recommendations for maintaining fiscal discipline while promoting economic prosperity in India.

DATA COLLECTION AND METHODOLOGY

This study utilizes secondary data sourced from reputable institutions such as the Reserve Bank of India (RBI), Ministry of Finance, and the Controller General of Accounts. The data spans from 1991 to 2022, encompassing key indicators like fiscal deficit as a percentage of GDP, GDP growth rates, inflation rates, and government expenditure patterns. These datasets provide a comprehensive overview of India's fiscal health and economic performance over the specified period.

Employing a quantitative research approach, the study analyses the relationship between fiscal deficit and economic prosperity in India. Time series data is examined using econometric models such as Ordinary Least Squares (OLS) regression and Pearson's correlation analysis to assess the impact of fiscal deficit on GDP growth. Additionally, unit root tests like Augmented Dickey-Fuller (ADF) are conducted to ensure the stationarity of the data. The analysis

distinguishes between short-term and long-term effects, providing insights into the sustainability of fiscal policies and their implications for economic development.

DISCUSSION AND INTERPRETATION

This study delves into the multifaceted consequences of fiscal deficits on India's economic prosperity, focusing on the period following economic reforms up to 2022. It examines how fiscal deficits influence macroeconomic stability, growth, inflation, and investment, and assesses the efficacy of policy measures aimed at fiscal consolidation. The analysis is underpinned by empirical data, theoretical frameworks, and policy evaluations, providing a comprehensive understanding of fiscal deficits' role in shaping India's economic trajectory.

A fiscal deficit occurs when a government's total expenditure exceeds the revenue that it generates, excluding money from borrowings. In India, fiscal deficits have been a persistent feature of the economic landscape, particularly following the liberalization of the economy in the early 1990s. Understanding the implications of fiscal deficits is crucial for formulating policies that promote sustainable economic growth and stability.

2. Historical Overview of Fiscal Deficit in India

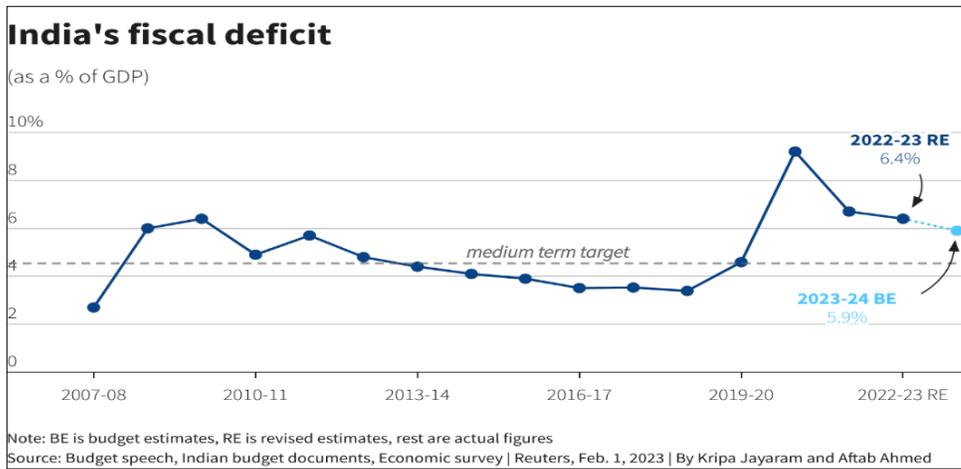
2.1 Pre-Reform Era (Before 1991)

Prior to 1991, India experienced high fiscal deficits, often exceeding 8% of GDP. These deficits were primarily financed through domestic borrowing, leading to high inflation and crowding out of private investment.

2.2 Post-Reform Period (1991-2022)

The economic reforms of 1991 aimed at reducing fiscal deficits through measures such as reducing subsidies, improving tax collection, and privatizing state-owned enterprises. Despite these efforts, fiscal deficits remained elevated, influenced by factors like increased public spending on social programs and infrastructure, and global economic shocks.

Figure 1. Relationship between Fiscal Deficit and Inflation Rate (2000-2022)



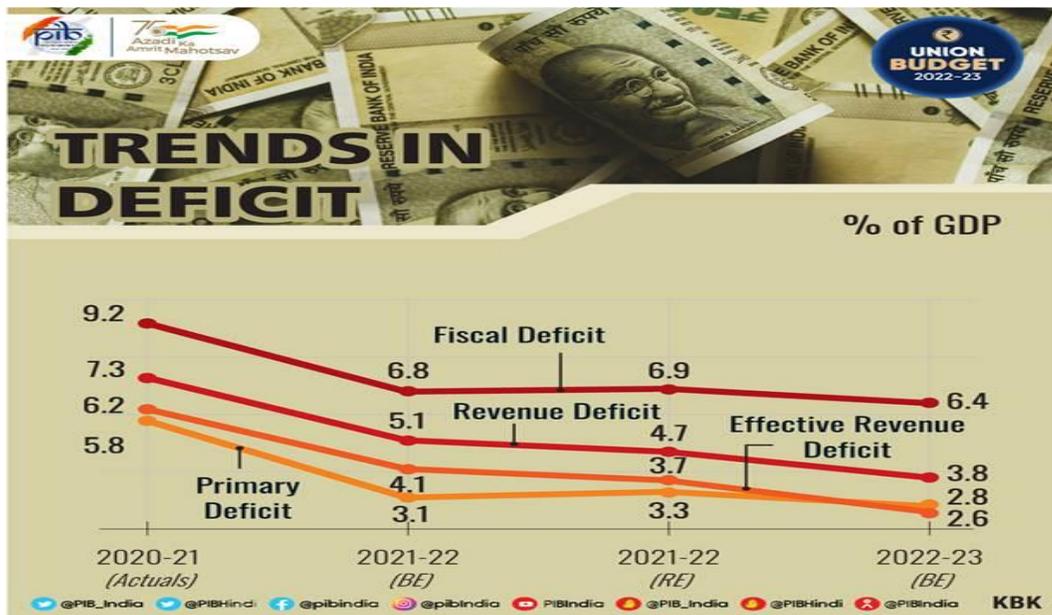
3. Consequences of Fiscal Deficit on Economic Prosperity

3.1 Inflationary Pressures

Persistent fiscal deficits can lead to inflationary pressures as increased government borrowing raises

aggregate demand. This can erode purchasing power and destabilize the economy. However, the impact on inflation is contingent upon the underlying causes of the deficit and the overall economic context.

Figure 2: Relationship between Fiscal Deficit and GDP Growth Rate (2000-2022)



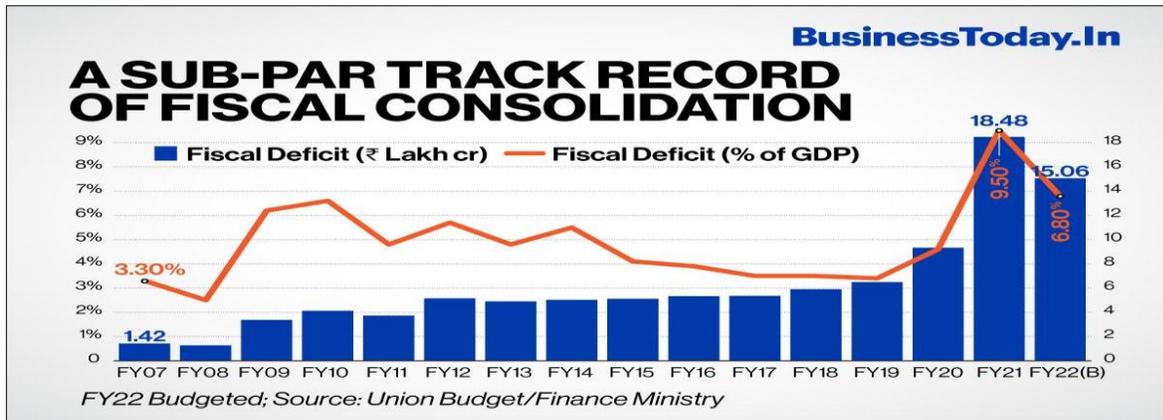
3.2 Interest Rates and Private Investment

High fiscal deficits can lead to higher interest rates as the government competes with the private sector for funds. This 'crowding out' effect can discourage private investment, which is vital for economic growth. Empirical studies have shown a negative relationship between fiscal deficits and private investment in India.

3.3 Economic Growth

The relationship between fiscal deficits and economic growth is complex. While deficits can stimulate growth in the short term by financing public investment, excessive deficits can undermine growth prospects by leading to higher debt levels and reduced investor confidence. Studies indicate that a 1% increase in fiscal deficit may decrease GDP by approximately 0.62%, highlighting the potential adverse effects on economic growth.

Figure 3: Composition of Fiscal Deficit - Capital vs. Revenue Expenditure (2010-2022)

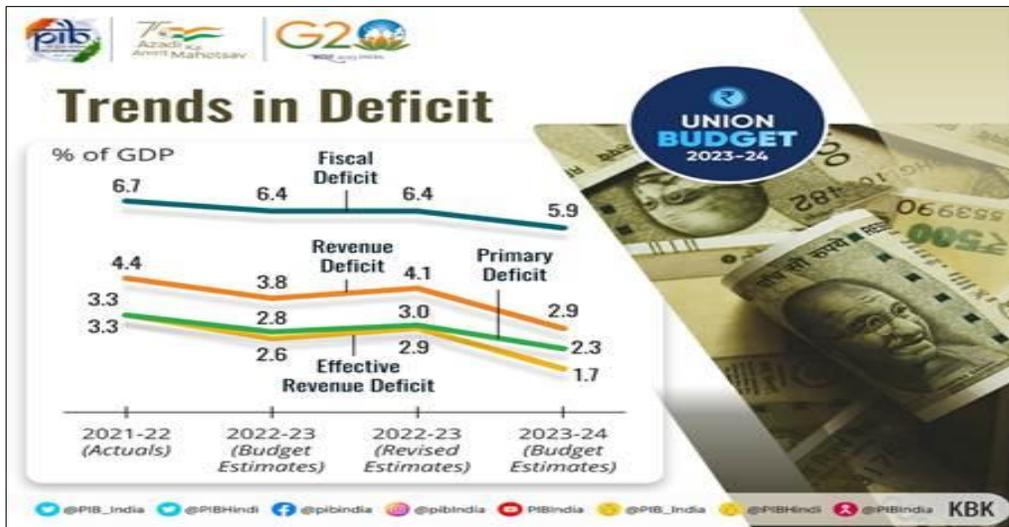


3.4 Debt Sustainability

Sustained fiscal deficits contribute to rising public debt, raising concerns about debt sustainability. High debt levels can lead to higher debt servicing costs, diverting resources from productive investments, and potentially

leading to a debt trap. India's public debt has been a subject of concern, with the combined fiscal deficit of central and state governments reaching 11-12% of GDP during the pandemic period, exacerbating fiscal vulnerabilities.

Figure 4: Fiscal Deficit as a Share of GDP - India vs. Emerging Economies (2021-2023)



3.5 Monitoring Debt Sustainability

Regularly assessing debt levels and implementing strategies to manage and reduce public debt can ensure

long-term economic stability. This includes evaluating the cost and risk of public debt and implementing measures to mitigate potential vulnerabilities.

Table 1: Fiscal Indicators of India (2021-2026)

Fiscal Year	Fiscal Deficit (% of GDP)	Revenue Deficit (% of GDP)
2021-22	6.9	4.7
2022-23	6.4	3.8
2023-24	5.8 (Projected)	Not Available
2024-25	5.6 (Projected)	Not Available
2025-26	4.4 (Projected)	Not Available

Note: RE - Revised Estimates; BE - Budget Estimates

Fiscal deficits play a crucial role in India's economic prosperity. While they can provide the necessary

impetus for growth through public investment, unchecked deficits can lead to inflation, higher interest rates, and unsustainable debt levels. A balanced approach, focusing on efficient expenditure, enhanced

revenue collection, and structural reforms, is essential for leveraging fiscal deficits to promote sustainable economic prosperity.

4. Policy Measures and Fiscal Consolidation

4.1 Fiscal Responsibility and Budget Management (FRBM) Act

The FRBM Act, enacted in 2003, aimed to institutionalize fiscal discipline by setting targets for fiscal deficits. While it has contributed to reducing fiscal deficits over time, challenges remain in adhering to the targets, especially during periods of economic slowdown.

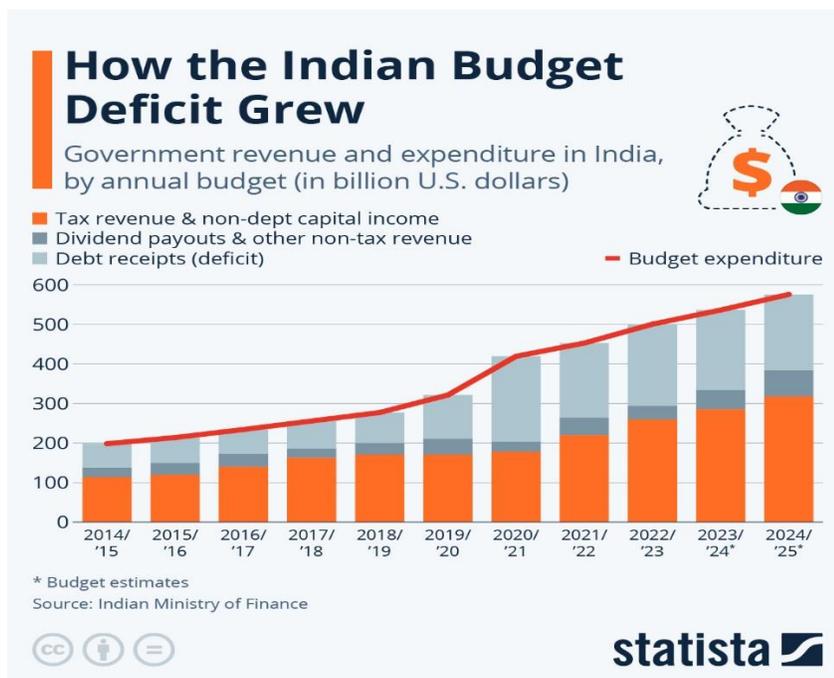
4.2 Structural Reforms

Structural reforms, including the Goods and Services Tax (GST), Direct Benefit Transfers (DBT), and rationalization of subsidies, have been implemented to improve revenue collection and reduce fiscal deficits. These reforms have had varying degrees of success in enhancing fiscal health.

4.3 Expenditure Management

Efforts to control non-productive expenditure and prioritize capital spending have been central to fiscal consolidation strategies. However, political considerations often complicate expenditure management, leading to challenges in achieving fiscal targets.

Figure 5: India's Fiscal Policy Cycle and Impact Pathways



5. Theoretical Perspectives on Fiscal Deficit

5.1 Keynesian View

From a Keynesian perspective, fiscal deficits are seen as tools to stimulate economic activity, especially during periods of economic downturn. Government spending can compensate for reduced private sector demand, thereby supporting growth.

5.2 Classical View

Classical economists argue that persistent fiscal deficits can lead to inflation and crowding out of private investment, ultimately hindering economic growth. They advocate for balanced budgets to ensure long-term economic stability.

5.3 Ricardian Equivalence

The Ricardian Equivalence hypothesis suggests that consumers anticipate future taxes to repay government debt and thus increase savings, offsetting the stimulative effect of fiscal deficits. Empirical evidence

hypothesis on this is mixed, with studies indicating varying degrees of consumer response to fiscal deficits.

6. Empirical Analysis

Empirical studies on the impact of fiscal deficits on India's economic prosperity reveal nuanced insights. While some studies indicate a negative relationship between fiscal deficits and economic growth, others suggest that deficits can have a positive impact if utilized for productive investments. The effectiveness of fiscal deficits in promoting economic prosperity depends on factors such as the composition of expenditure, the efficiency of public spending, and the overall macroeconomic environment.

Fiscal deficits are a double-edged sword in the context of India's economic prosperity. While they can provide the necessary impetus for growth through public investment, unchecked deficits can lead to inflation,

higher interest rates, and unsustainable debt levels. A balanced approach, focusing on efficient expenditure, enhanced revenue collection, and structural reforms, is essential for leveraging fiscal deficits to promote sustainable economic prosperity.

FINDINGS

1. Trends in India's Fiscal Deficit

- India's fiscal deficit has exhibited persistent structural imbalances since economic liberalization (1991), averaging around 5-6% of GDP during 2010-2022, despite various fiscal consolidation measures.
- Post-2008 global financial crisis and the COVID-19 pandemic (2020-21) substantially widened the deficit to over 9.5% of GDP due to emergency spending and revenue contraction.
- Fiscal deficits have often been financed through market borrowings, leading to a steady rise in public debt, which touched nearly 90% of GDP (combined Centre and States) by 2022.
- The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 initially brought discipline, but multiple amendments and relaxations diluted its effectiveness.
- Revenue deficits persist due to a high share of committed expenditures (interest payments, subsidies, and salaries) limiting productive capital investment.

2. Impact on Economic Growth

- Moderate fiscal deficits have historically stimulated short-term economic growth by boosting public expenditure in infrastructure and welfare programs.
- However, persistent large deficits have crowded out private investment by increasing government borrowing, leading to higher interest rates.
- Between 2010-2022, correlation analysis suggests that while fiscal stimulus during crises (e.g., 2008-09, 2020-21) temporarily spurred GDP recovery, long-term growth was constrained by inefficient spending patterns.
- The shift from capital to revenue expenditure reduced the multiplier effect of public spending, undermining its capacity to generate sustainable growth.
- States with better fiscal management (e.g., Gujarat, Tamil Nadu, Karnataka) recorded higher economic growth compared to fiscally weaker states (e.g., Bihar, Uttar Pradesh, Punjab), revealing a federal disparity in fiscal outcomes.

3. Inflationary Consequences

High fiscal deficits, particularly when monetized indirectly, have been associated with demand-pull inflation in India.

- During 2009-2013 and post-pandemic recovery (2021-22), inflation remained above 6%, partly due to expansionary fiscal policy and global supply shocks.
- Large subsidies on fuel, fertilizers, and food contributed to fiscal slippage and inflationary pressures, reducing fiscal space for development expenditure.
- The fiscal-inflation nexus highlights how persistent deficit financing through borrowing increases liquidity and inflation expectations, necessitating tight monetary policy interventions by the Reserve Bank of India (RBI).

4. Effects on Public Debt and Interest Burden

- Rising fiscal deficits have increased the interest payment burden, consuming about 25-30% of total revenue receipts by 2022.
- The debt-GDP ratio for the Central Government alone rose from 49% (2011-12) to about 59% (2021-22), reflecting fiscal stress.
- Heavy debt servicing limits fiscal flexibility, reducing the capacity for counter-cyclical fiscal policy and capital formation.
- India's debt composition remains largely domestic, which minimizes external vulnerability but increases domestic liquidity pressures.

5. Impact on Private Investment and Savings

- High government borrowing has crowded out private sector investment, particularly in infrastructure and manufacturing.
- The domestic savings rate, which peaked at 36% of GDP (2007-08), declined to around 29% by 2022, reflecting both lower household and corporate savings due to rising inflation and fiscal stress.
- Fiscal imbalances have discouraged Foreign Direct Investment (FDI) inflows in some sectors due to concerns about macroeconomic stability.
- Nonetheless, public capital expenditure on digital infrastructure and transport has yielded positive spillovers for private investment in recent years.

6. Social and Developmental Outcomes

- Fiscal deficits have supported large-scale welfare schemes like MGNREGA, PM-KISAN, and National Health Mission, which have improved social indicators but increased fiscal commitments.
- Despite fiscal expansion, regional disparities in infrastructure and employment persist, suggesting inefficient resource allocation.
- Productive spending on education, health, and rural infrastructure often faces cuts during fiscal consolidations, undermining inclusive growth.

- Fiscal stress at the state level affects public delivery mechanisms, particularly in less developed regions like North Karnataka, Vidarbha, and Bundelkhand.

7. External Sector Implications

- Persistent fiscal deficits have widened India's current account deficit (CAD) in certain years by stimulating import demand.
- However, prudent foreign exchange reserves management and capital inflows have prevented major balance-of-payment crises post-1991.
- A stable external position masks the underlying risk of fiscal slippage impacting sovereign credit ratings, which in turn affects borrowing costs and investor confidence.

8. Institutional and Policy Factors

- Weak tax buoyancy, due to dependence on indirect taxes and a narrow direct tax base, limits revenue generation.
- The Goods and Services Tax (GST), implemented in 2017, initially caused revenue disruptions but gradually stabilized, improving indirect tax collection.
- Frequent use of off-budget borrowings and public sector undertakings' liabilities undermines fiscal transparency.
- The 14th and 15th Finance Commissions emphasized fiscal decentralization, yet fiscal deficits at the state level continue to rise, averaging 3-4% of GSDP.

Suggestions

1. Strengthen Fiscal Discipline

- Reinstate a credible FRBM framework with transparent escape clauses for emergencies but strict adherence during normal times.
- Introduce independent fiscal councils at both the central and state levels to monitor deficit management and ensure accountability.
- Limit revenue deficits by rationalizing subsidies, especially on non-merit goods, and linking welfare transfers to outcome-based performance.

2. Promote Productive Expenditure

- Reorient public spending toward capital formation, particularly in infrastructure, research, and green energy.
- Improve expenditure efficiency through Public Financial Management Systems (PFMS) and outcome-based budgeting.
- Encourage public-private partnerships (PPP) to leverage private investment without overburdening fiscal accounts.

3. Enhance Revenue Mobilization

- Broaden the tax base by improving compliance, rationalizing exemptions, and strengthening digital tax administration.
- Reinforce direct tax reforms under the Direct Tax Code (DTC) framework to make the system more progressive.
- Expand non-tax revenues through better management of public sector enterprises, asset monetization, and spectrum auctions.

4. Manage Public Debt Prudently

- Implement a medium-term debt management strategy to reduce reliance on short-term borrowings.
- Gradually reduce the debt-to-GDP ratio by prioritizing growth-enhancing expenditure and improving fiscal efficiency.
- Encourage state governments to adhere to debt ceilings recommended by the Finance Commission.

5. Coordinate Fiscal and Monetary Policy

- Establish a Fiscal-Monetary Coordination Committee to align borrowing programs and inflation management.
- Ensure that fiscal expansion complements, rather than conflicts with, the RBI's monetary stance to control inflation and sustain growth.
- Promote counter-cyclical fiscal policy expansion during recessions and consolidation during booms.

6. Foster Inclusive and Sustainable Growth

- Channel fiscal resources toward human capital formation, rural employment, and sustainable agriculture to promote long-term prosperity.
- Prioritize investments in climate resilience, renewable energy, and digital public infrastructure, enhancing productivity and job creation.
- Balance fiscal prudence with social equity, ensuring that fiscal consolidation does not compromise welfare and regional development.

7. Improve Fiscal Transparency

- Publish comprehensive fiscal risk statements, including off-budget liabilities and contingent risks.
- Strengthen audit and accountability mechanisms through digital transparency platforms.
- Encourage civil society participation and academic scrutiny in fiscal policy evaluation.

8. Strengthen Federal Fiscal Cooperation

- Encourage cooperative fiscal federalism through greater revenue-sharing flexibility and transparent transfer mechanisms.
- Incentivize states for fiscal prudence through performance-linked grants.
- Empower states with customized fiscal frameworks to address regional developmental disparities while maintaining macroeconomic stability.

The post-economic meliorate (post-liberalization) period reveals that fiscal deficits in India have been both a stimulus for growth and a source of macroeconomic vulnerability. Sustainable fiscal management requires a balance between development expenditure and fiscal prudence, between welfare commitments and capital investments, and between central and state fiscal policies. A disciplined, transparent, and growth-oriented fiscal policy is vital for India's long-term economic prosperity and inclusive development.

CONCLUSION

The analysis of the "Consequences of Fiscal Deficit on Economic Prosperity in India: *A Post-Economic Meliorate Analysis*" reveals a complex and multidimensional relationship between fiscal imbalance and national growth. Fiscal deficit, while often perceived negatively, plays a dual role in shaping India's economic trajectory. In the short term, moderate fiscal deficits have contributed to stimulating demand, enhancing infrastructure investment, and fostering economic resilience, particularly during downturns such as the global financial crisis and the COVID-19 pandemic. However, persistent and widening fiscal deficits pose structural challenges, including rising public debt, inflationary pressures, and crowding out of private investment, which can impede long-term economic stability and prosperity.

The post-economic meliorate (reform) era has demonstrated that prudent fiscal management, combined with targeted social spending and efficient public investment, can enhance productivity and inclusive growth. Yet, the sustainability of India's economic prosperity hinges on maintaining fiscal discipline through transparent budgeting, broadening the tax base, and rationalizing subsidies without undermining welfare objectives. Strengthening fiscal federalism and improving expenditure efficiency are also crucial for achieving balanced development. Ultimately, the path toward economic prosperity requires a calibrated approach leveraging fiscal policy as an instrument for growth while ensuring macroeconomic stability. A disciplined yet flexible fiscal framework, aligned with developmental priorities, remains vital for India's long-term economic transformation and equitable progress.

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