Fiscal Deficits, Capital Taxes, and Investment in India

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Abstract

India stands alone among its emerging market peers in taxing mobile capital, charging twenty percent on short term gains and twelve percent on long term gains, a rate hiked as recently as 2024. Anupam Manur argues this is not an isolated policy quirk but a symptom of a much larger structural problem: the Indian state's persistent appetite for revenue, driven by a fiscal deficit that has stayed above five percent of GDP for years.

Manur traces how this appetite plays out on two fronts. On the taxation side, it shows up as high GST slabs, retrospective taxes, and a tendency to chase any taxable base until investors and companies start leaving. On the borrowing side, it shows up as financial repression, where instruments like the Statutory Liquidity Ratio effectively guarantee the government a captive pool of lenders inside the banking system, crowding out private borrowers. He lays out the numbers on India's savings rate versus government borrowing to show just how tight the room for private credit has become, and he closes by proposing a specific institutional fix: an independent fiscal council with real enforcement teeth, something successive Finance Commissions have recommended and successive governments have declined to create.

The notes below follow Manur's argument from the immediate problem of capital flight, through the deeper fiscal roots of that problem, to the institutional solution he proposes.

Supplementary Resources

- **Six reasons why fiscal councils can help create sustainable public finance in the post-pandemic world** by Kandarp Patel and Srinivas Gurazada (Resource) [1]
- **[Unverified] NIPFP Library accession/new-arrivals list, 12 May 2017** by National Institute of Public Finance and Policy (Library) (Resource) [2]

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India's unique tax on mobile capital

[00:00:09] Anupam Manur: India is the only country in the world that taxes mobile capital. Indian government places a tax rate of twenty percent on short term capital gains and twelve percent on long term capital gains. This itself was raised in 2024. Now, this goes completely against the normal trend in the world.

[00:00:09] Anupam Manur: Most of the other competitors of India do not place such a tax.

[00:00:36] Anupam Manur: South Korea, for example, does not place any tax until you hold twenty-five percent of the company. Taiwan, Hong Kong, Brazil, all of the other countries with whom we generally compete for in terms of capital, do not place such a tax. But India does.

[00:00:52] Anupam Manur: Now, this particular tax policy has resulted in an outflow of capital in 2023, 2024, 2025, and in the preceding years. In normal circumstances, when the Indian economy is doing good, when the global conditions are perfect, there's no problem. The premium that investors get by coming to India is still higher than the friction that we have created.

[00:01:21] Anupam Manur: However, when the global scenario becomes a lot more discretionary, when the global scenario becomes a lot more difficult, then you tend to have capital also becoming a lot more discretionary. So, for instance, now because of the Iran war, the entire trade war, you have a whole bunch of events that are occurring in the world, which has directly impacted how investors look.

[00:01:47] Anupam Manur: And in such situations, investors generally tend to flee countries which have a higher risk premium and countries which impose a lot more friction. And India is in the latter category.

Capital outflows accelerate in 2026

[00:02:00] Anupam Manur: So, in 2026 alone, 1.92 trillion dollars left India between January and April of 2026. This is more than the entire 2025 combined. This should give you an idea of the flow of capital.

[00:02:17] Anupam Manur: Why is this happening? One, as I said, friction is high, and two, India is no longer offering a story for investors. Until now, India was the emerging market which was the darling of investors, when capital was cheap and there was global certainty. Investors didn't mind coming to India.

[00:02:17] Anupam Manur: But now, investors are exiting emerging markets and going to other countries.

India losing its investor story

[00:02:42] Anupam Manur: And especially countries such as Taiwan and South Korea are offering AI stories that India is not. So this begs the question. Why are we putting such a high tax on mobile capital when no one else isn't? The easy answer is, of course, to say, why should we not?

[00:02:42] Anupam Manur: When we put tax on income tax, on consumption of normal goods and services, why should capital be left alone?

[00:03:09] Anupam Manur: But that is an insufficient answer. The problem is that unlike a consumer in India who can't easily exit the country and go somewhere else, mobile capital can. Capital can flee the country and go abroad, which is exactly what is happening.

The state's voracious appetite for revenue

[00:03:25] Anupam Manur: So the bigger question then again remains, why do we place such a tax? The answer is systematic. It is not an error that occurred in 2024. It is not something which is out of the ordinary, but it is a systematic problem.

[00:03:25] Anupam Manur: And that systematic problem is Indian state's voracious appetite for revenue.

[00:03:47] Anupam Manur: And it has such a voracious appetite for revenue because it spends so much. Now, let's jump the sections a little bit and think about why is it that the Indian state spends so much and what is the impact of it. The Indian governments successively have had a fiscal deficit, a structural fiscal deficit of five percent or above. And in all of this time, where sometimes it's been undercounted, sometimes it's been reported a little bit more honestly, but the truth remains that Indian government's fiscal deficit is high for a developing country.

[00:04:25] Anupam Manur: And this fiscal deficit has to be financed somehow, and that financing is what creates this problem. That financing is usually done either through taxation or through borrowing. And you will see how each one of them create its own problems.

Taxation strategy and rising GST slabs

[00:04:43] Anupam Manur: In terms of taxation, this is where all of the problems come about, whether we're taxing FIIs or whether we go after companies more than any other country, whether it is about retrospective taxation, all of this is different symptoms of the same problem that we go after any base that can be taxed.

[00:05:04] Anupam Manur: Why is it that India has one of the highest levels of GST? Why is it that we impose twenty-eight percent GST on what would otherwise be thought of as essential commodities? Why is it that we have eight different slabs? I mean, on paper, we have four, but in reality, we have up to eight different slabs of GST, so that we can put more and more tax on elastic bases.

[00:05:04] Anupam Manur: You're rich, you pay a higher tax. And we keep doing this until they exit.

Government borrowing and financial repression

[00:05:35] Anupam Manur: The other part of the story is the borrowing. Now, the Indian government, of course, borrows a lot. Unlike other countries which are deeply in debt, the Indian government doesn't borrow as much from foreign players, but borrows domestically. And this could be seen in terms of financial repression, in the way that Indian government borrows from banks, which will then limit the lending ability of these banks.

[00:06:01] Anupam Manur: For instance, the cash reserve ratio, which is financial prudence norms, is about three percent, which is pretty much in accordance with the rest of the world. But India additionally puts something called the statutory liquidity ratio. And that can be as high as eighteen percent. It's been decreasing in the last few years, but it is still extremely high.

[00:06:01] Anupam Manur: So for every one hundred rupees that is deposited in a bank, twenty-one rupees cannot be touched for lending purposes.

[00:06:28] Anupam Manur: This is exceptional prudence, or is it really a way to finance government deficits? Because of that eighteen percent in statutory liquidity ratio, all of that has to be invested in AAA rated securities and government approved securities. And guess what? Most of that, of course, goes to the government itself.

[00:06:28] Anupam Manur: So it's in a way having a guaranteed lender for the government.

[00:06:57] Anupam Manur: But the bigger problem, of course, is that when you have the government being one of the biggest borrowers, you will not have enough space for private borrowings.

Savings rate and crowding out corporates

[00:07:09] Anupam Manur: Let's look at this scenario in slightly more detail. The savings rate in India is about thirty to thirty-one percent of GDP. Now, of course, of which governments don't save, corporates rarely save, or if they do, they sometimes reinvest. But the biggest saver in the Indian context, if you leave the external sector apart, is the household sector.

[00:07:30] Anupam Manur: Now, the household sector, of course, saves, but unfortunately, a lot of that saving is in unproductive uses. And this could be gold, real estate, things that cannot be used for lending. So what is the actual percentage of savings that can be used? Five point one percent.

[00:07:30] Anupam Manur: So the household sector financial sector savings is five point one percent.

[00:07:51] Anupam Manur: Keep that number in the corner of your head. On the other end, let's look at where does this go? The government of India, which is the union government already has a structural fiscal deficit of about five percent. Now, last year it was four point five percent, but even before that it was five percent and COVID really put that number much higher levels.

[00:08:16] Anupam Manur: But even if you take that to be around, let's say, four point five percent. Then there are state governments. State government borrowing is about three percent of GDP. Fiscal deficit of state governments is three percent of GDP.

[00:08:16] Anupam Manur: You add that together, you already have seven point five percent of GDP. Then you have public sector units. That contributes to about one point five percent of GDP. So borrowing from union government, state governments, plus PSUs is already at about nine percent of GDP.

[00:08:42] Anupam Manur: The savings is five point one percent of GDP. If the government takes away all of the money that is there by the savers, where do corporates borrow from? We don't have a functioning bond market. We barely have long term institutional borrowing.

[00:08:42] Anupam Manur: Some of it can be gotten through external commercial borrowings, but by and large, corporates are left without opportunities to borrow. And with that comes problems of job creation, of investment rates, and a whole bunch of other macroeconomic problems.

Proposing an independent fiscal council

[00:09:12] Anupam Manur: So, how do we solve all of this? How do we make sure that we're not taxing away investment opportunities? How do we make sure that we're not taxing away corporates? How do we make sure that we are not borrowing at such an extent that others don't have enough money to borrow?

[00:09:12] Anupam Manur: One solution, and this is by no means the silver bullet, is to have an independent fiscal council.

[00:09:37] Anupam Manur: This is one of those areas that has not been reformed. An independent fiscal council would essentially look at your budgets, would look at all kinds of government schemes, would keep the expenditures in check, would actually check for how much revenue is being collected, and so on and so forth. Now, many countries have successful independent fiscal councils, which can in some way limit the extent of borrowing and expenditure from the government.

[00:10:08] Anupam Manur: And such an institution within India, I think can go a long way in terms of disciplining the government, in terms of introducing a little bit of fiscal discipline. Now, by no means is it enough to just have an institution. There's already, for example, the FRBMA. It's not an institution, but it's an act by the parliament in 2003.

Why the FRBMA targets failed

[00:10:32] Anupam Manur: The FRBMA or the Fiscal Responsibility and Budgetary Management Act aimed to do exactly this, which is limit the spending of the government. But the targets that were set by FRBMA has been routinely breached. The FRBM, for example, set targets that the union government's fiscal deficit have to be three percent of GDP. All of the state governments put together had to be three percent of GDP.

[00:10:32] Anupam Manur: Revenue deficit had to be brought down to zero, and so on and so forth.

[00:11:00] Anupam Manur: But none of these targets have almost ever been met. And the reason for that is because it's unenforceable. Those targets can easily be extended, those targets can be rewritten, you can find ways around those targets. So, if you don't have targets and strict rules for enforcement, then any of these laws will just not make sense.

Finance commission as a working model

[00:11:25] Anupam Manur: That is where hopefully, a fiscal council with enough teeth in it, where you can't bypass that institution, is important. The finance commissions, for example, gives you one idea of a successful institution. Now, the finance commission, at least in terms of devolution of funds from the union government to states, the formulas have generally been adhered to. Once the finance commission proposes and gives its recommendations, those recommendations are usually met by the union government.

[00:11:56] Anupam Manur: Can we now imagine a fiscal council doing the same? In fact, speaking of these two institutions, almost every single finance commissions from the thirteenth till the fifteenth have recommended for an independent fiscal council. And in almost every case, that particular recommendation has not been taken by the union government. That tells you that the union government does not want its hands to be bound in terms of its expenditure.

[00:11:56] Anupam Manur: It does not like its discretionary powers to be taken away.

[00:12:24] Anupam Manur: But given the magnitude of the problems by not having such discipline, I think it's time that the government bites the bullet and introduces a fiscal council.

References

[1] Patel, Kandarp, and Srinivas Gurazada. "Six reasons why fiscal councils can help create sustainable public finance in the post-pandemic world." World Bank Blogs, Governance for Development, January 14, 2021. https://blogs.worldbank.org/en/governance/six-reasons-why-fiscal-councils-can-help-create-sustainable-public-finance-post-pandemic.

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