

MALAVIYA NATIONAL INSTITUTE OF TECHNOLOGY, JAIPUR



COMPUTER SCIENCE AND ENGINEERING
DEPARTMENT

ECONOMICS REPORT

Topic: FISCAL CONSOLIDATION- *NEED*
OF HOUR IN INDIA

SUBMITTED TO: MA'AM SWATI
SUBMITTED BY: UJESH MAURYA (2015UCP1338)
JOYDIP SARKAR (2015UCP1337)
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FISCAL CONSOLIDATION- *NEED OF*
HOUR IN INDIA



INDIA'S MOST CRUCIAL STEP TO REDUCE BURDEN ON GOVERNMENT

Introduction

Fiscal consolidation is a process where government's fiscal health getting improved indicated by reduced fiscal deficit which is manageable and bearable for the economy. Improved tax revenue realization and better aligned expenditure are thus components of fiscal consolidation.

According to Financial time's lexicon, "Fiscal

consolidation is a reduction in the underlying fiscal deficit. It is not aimed at eliminating fiscal debt.”

In India, fiscal deficit is the king indicator to show the fiscal health of the government. Effectively, fiscal deficit indicate the amount of government borrowing for that particular year.

Excess fiscal deficit produces some adverse effects. For the government it causes interest payment burden and for the economy it produces inflationary effect, and rising interest rate in the economy.

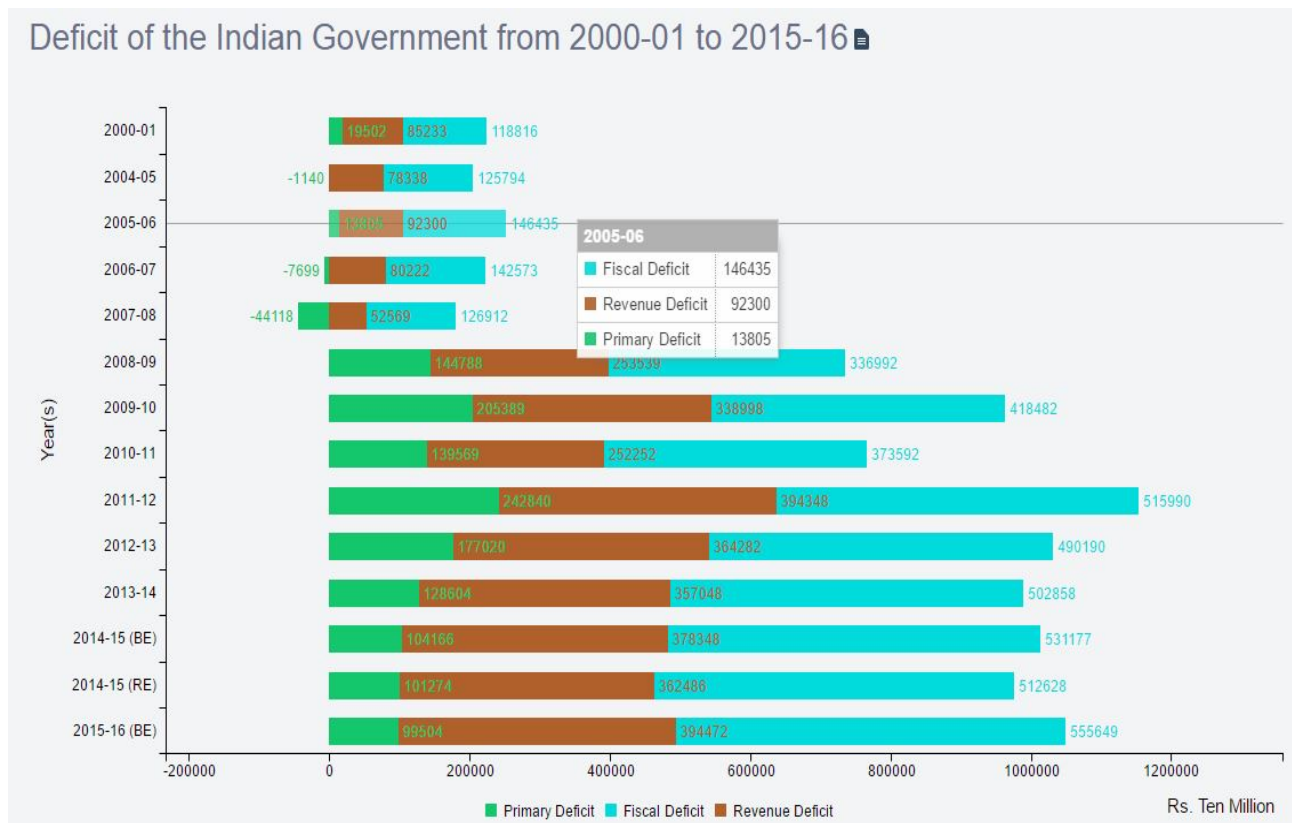
What is Fiscal Deficit ?

A fiscal deficit occurs when a government's total expenditures exceed the revenue that it generates, excluding money from borrowings. Deficit differs from debt, which is an accumulation of yearly deficits.

Data on Fiscal Deficit in India over last few years.

Source:

<https://community.data.gov.in/deficit-of-the-indian-government-from-2000-01-to-2015-16>) A digital India Initiative.



What is Fiscal Stimulus ?

Economic stimulus consists of attempts by governments or government agencies to financially stimulate an economy. An economic stimulus is the use of monetary or fiscal policy changes to kickstart growth during a recession.

Governments can accomplish this by using tactics such as lowering interest rates, increasing government spending and quantitative easing, to name a few.

The negative effects of Fiscal Stimulus are:

- 1) Fiscal Stimulus over a long period of time weakens government treasury and increases Fiscal Deficit.

- 2) It is a burden on Indian economy.
- 3) It triggers the cycle of fiscal deficits.
- 4) It creates Inflation, which in turn increase fiscal deficit. (a recursive cycle, which may end only after fiscal consolidation)

FISCAL POLICY

Fiscal policy is the means by which a government adjusts its spending levels and tax rates to monitor and influence a nation's economy.

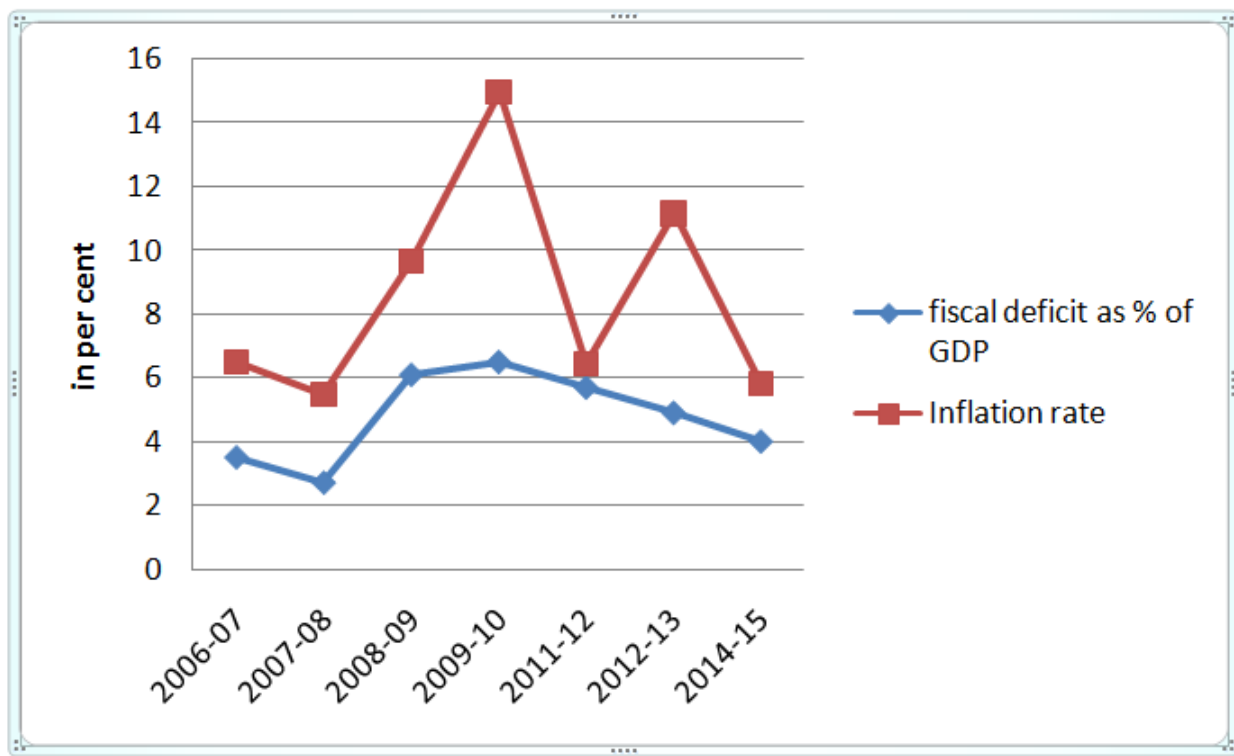
It is the sister strategy to monetary policy through which a central bank influences a nation's money supply.

The idea, however, is to find a balance between changing tax rates and public spending.

For example, stimulating a stagnant economy by increasing spending or lowering taxes runs the risk of causing inflation to rise. This is because an increase in the amount of money in the economy, followed by an increase in consumer demand, can result in a decrease in the value of money - meaning that it would take more money to buy something that has not changed in value.

NEED OF FISCAL CONSOLIDATION

Graph 1: Fiscal Deficit and Inflation Rates



Source: Economic Survey

As we can see in the graph that with the rise in fiscal deficit there is exponential growth in inflation.

Which means that to cover up the last year debt's interest and to satisfy government's expenditure we have to pay more this year.

That will consequently increase our Fiscal Deficit and which will in turn increase the Inflation.

This vicious cycle of deficit and inflation goes on and on. And there are many countries who fell into this debt trap; which ultimately leads to bankruptcy.

India surely doesn't want this to happen in near future.

Hence there is an urgent need of Consolidating our Fiscal Deficit and achieving Fiscal consolidation in India.

The above facts and logic says themselves that if India is to continue without fiscal consolidation in future then in no time a situation may arise where Fiscal deficits can never be recovered in any way.

There are many examples like Argentina and Jamaica where Government debts are more than 50% of GDP itself. Thus in order to avoid such bankruptcy FISCAL CONSOLIDATION is need of hour in INDIA.

ACHIEVING FISCAL CONSOLIDATION

FRBM Act 2003:

The Fiscal Responsibility and Budget Management Act, 2003 (FRBMA) is an Act of the Parliament of India to institutionalize financial discipline, reduce India's fiscal deficit, improve macroeconomic management and the overall management of the public funds by moving towards a balanced budget and strengthen fiscal prudence.

The main purpose was to eliminate revenue deficit of the country (building revenue surplus thereafter) and bring down the fiscal deficit to a manageable 3% of the GDP by March 2008.

Objectives of FRBM Act:

- 1) Government of India will gradually reduce its Fiscal deficit to a manageable of 3% of GDP and completely eliminate its Revenue Deficit by 2008-09.
- 2) Government of India will not borrow anything from Reserve Bank of India(RBI).
- 3) Government of India will not give GUARANTEE on more than 0.5% of GDP for loans taken up by PSUs.
- 4) The Finance Minister of India will present three major reports every year when the budget is announced:

a) Macro economic framework report consisting of GDP growth, fiscal imbalance and External account balance.

b) Fiscal Policy Strategy for the next year,

c) Mid term Fiscal policy consisting of four major parameters:

(i) Revenue Deficit.

(ii) Fiscal Deficit.

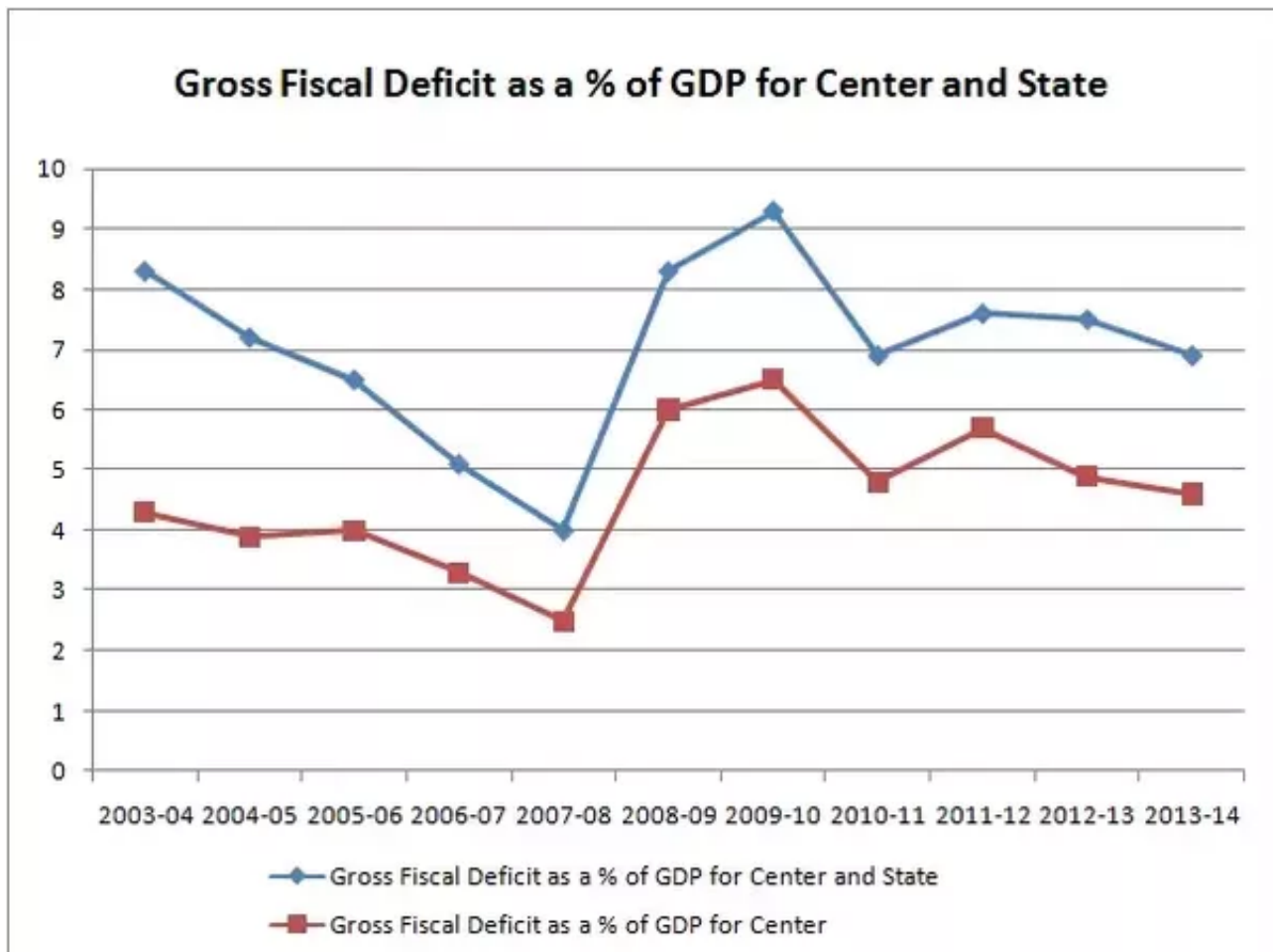
(iii) Tax to GDP ratio.

(iv) Total outstanding Debt.

For the first three years of FRBM act execution, everything went smooth and our economy was flourishing.

We were achieving a reduction of more than 0.5% in Revenue Deficit and reduction of more than 0.3% in Fiscal Deficit.

We can see this clearly in the graph below:



But in the year 2007-08 there comes a calamity, The Global Economical Slowdown; India too became it's victim and the government was in a Dilemma.

The dilemma was to follow the FRBM Rules or to help the economy to revive this tough period of time.

Our government choose the later option; and gave a Fiscal Stimulus package which comprised of two crucial features to help economy:

1) Reduction of Taxes: Excise Duty and Service Taxes were brought down heavily.

2) Public Expenditure Increased.

From the above two points we can infer that since taxes were reduced so the government will make less revenue.
Hence revenue Deficit Increased.

It can be easily inferred from the second point that our government started to spend more and hence our **Fiscal Deficit also Increased.**

Consequently the target deadline for achieving the FRBM objectives was shifted from 2008-09 to 2011-12 and then again to 2013-14.

But somehow the earlier government was not able to recover from the loss of slowdown of 2007-08 even after the economy was back on track.

International Agencies started to give us warnings about our increasing Fiscal Deficit.

Thus the new government took Fiscal Consolidation and FRBM act too seriously and achieved the annual reduction goal in back to back three years till 2016-2017.

But due to the fact that there was demonetization in India and lot of government expenditure was invested on that hence by the year 2017-18 it is almost impossible to achieve the mark of 3% Fiscal Deficit.

Hence Mr. Jaitley made an FRBM panel headed by N.K. Singh and Chief Economic Advisor to frame the targets and Fiscal Indicators for every year. *(YES, a lame excuse of government to blame Economists for the mistake(demonetization) they did)*

Summary

So summing up all we can say that Fiscal Consolidation is the need of hour in India and FRBM Act and FRBM panel is the key to achieve it.

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