Current Scenario of Fiscal Policy of India: Achievements, Limitations and Suggested Reforms

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Abstract

Fiscal policy had always been effective tools in the hands of modern day government to influence the size and components of national income, employment level, prices etc. For the developing countries major aim of the fiscal policy is to achieve economic development together with reducing the inequalities of income and wealth. Fiscal policy in India since very beginning focussed on promotion of capital formation and mobilisation of financial resources. Fiscal policy refers to the policy of government regarding taxation, public expenditure and public borrowing for the achievement of specific objectives. This article gives the details of the achievements of the fiscal policy in context of India. The article also discussed the limitations of the fiscal policy together with the suggested reforms.

Key words: Fiscal policy, Economic development, Taxation, Public expenditure, Public borrowings

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Introduction

In today's time, Government owes accountability to govern the country in an effective and efficient way. In this process of governance, certain expenditures are likely to incur like defence, maintenance of law and order, infrastructure facilities and development programmes. To meet out these expenditures Government formulates public expenditure programme and adopts taxation system to generate revenue. A budget is prepared by Government every year to manage public expenditure and revenue of the economy. A policy comprising all these components is called Fiscal Policy.

Meaning

Fiscal policy is a method by which a government balances its spending level and tax rates to monitor and influences a nation's economy. It is a economic measures through which government control its Public Expenditure, Public Revenue and Public

Debts. It is the supplement strategy to Monetary Policy through which a Central bank influences a nation's money supply.

According to **Arthur Smithies,** "Fiscal Policy refers to a policy under which the government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production and employment."

Therefore Fiscal Policy refers to the entire budgetary policy of the government. It also includes Public Borrowing and Deficit Financing.

Achievements of Fiscal Policy in India

The following are some of the important achievements of the fiscal policy in context to economy of India.

Formation of Capital: Fiscal policy had played a vital role in raising the rate of capital formation of the country. It is equally useful in both sector public as well as private. In simple words Gross Capital Formation is Investment.

Rate of Gross Capita Formation is arrived as: $\frac{\text{Investment}}{\text{GDP}} * 100$

The GCF as percentage of GDP in India had increased from 10.2% in 1950-51 to 24.8% in 1997-98. GCF as percentage of GDP in India was reported at 32.75 % in 2015.

Mobilisation of Resources: Mobilisation of resources means freeing up of locked resources of the country. It is vital for growth and development of the country. The Fiscal policy of the country has been helpful in mobilising substantial amount of resources through taxation, public debt etc. in financing various developmental projects. The extent of resource mobilisation which was 70% in 1965-66 had increased to 95% in 2010-11.

Encouragement to Private Sector: Fiscal policy of the country helps the private sector by providing necessary inducements in form of tax concession, tax exemptions, tax holidays and so on. These inducements are incorporated in budget to provide adequate incentives to the private sectors engaged in heavy industry, infrastructure and software. Private sectors units are also encouraged by giving subsidies to setup in backward areas and export oriented units. Therefore encouragement to private sectors helps in maintaining balance in regional development and promoting export of the country.

Induce Savings: Various incentives had been given in the fiscal policy to increase the rate of savings both in household and corporate sectors. Tax exemption and rebate are being provided in opting and saving funds through fixed deposits, life insurance schemes, Kisan Vikas Patra, National Saving Certificate in household. For encouragement in saving by corporate sectors tax concession and tax benefit are also offered to business units.

Gross household savings according to annual report of RBI for Financial Year 2015-16 was 18.7% of GDP.

Gross Domestic Savings = Gross Domestic Production – Final Consumption-Expenditure

According to World Bank GDS as percentage of GDP in India was reported as 30.43% in 2015 while it was 31.1% in 2014. However personal saving in India increased to 26099.21 INR Billion in 2016 from 25429.60 INR Billion in 2015.

The fiscal policy is to achieve economic development together with reducing the inequalities of income and wealth. Fiscal policy in India since very beginning focussed on promotion of capital formation and mobilisation of financial resources. Fiscal policy refers to the policy of government regarding taxation, public expenditure and public borrowing for the achievement of specific objectives.

Poverty Alleviation and Employment Generation: One of the major objectives of fiscal policy is to provide full employment. In order to fulfil this objective substantial amount of fund had been allocated through fiscal policy to reduce poverty and unemployment. Various schemes and programmes had been launched in budget to eradicate poverty and generate employment. For e.g. Twenty Point Programme, Integrated Rural Development Programme, Jawahar Roojgar Yojana, Pradhan Mantri Roojgar Yojana, Employee Assurance Scheme, Swarna Jayanti Shahari Roojgar Yojana and above all Mahatma Gandhi National Rural Employment Guarantee Act.

According to World Bank report in 2015, India's poverty rate for the period 2011-12 stood at 12.4% of the total population, or about 172 million people, a reduction from 29.8% in 2009. Unemployment rate in India decreases to 4.90% in 2013 from 5.20% in 2012. Unemployment rate in India averaged 7.32% from 1983 until 2013 reaching an all time high of 9.40% in 2009 and record low of 4.90% in 2013.

Reduction in Equality of Income and Wealth: Constant efforts had been made in our fiscal policy to reduce inequality of distribution of income and wealth in the country. Progressive rate of tax on income and wealth, corporate tax, capital gain together with grants, rebate and subsidies are making joint efforts to mobilise the resources from rich to poor and thus reducing inequality.

Export Promotion: Export of the country are promoted through various measure of fiscal policy such as subsidies, tax concession, tax holidays, tax exemption. The grow rate of export had increased from 4.6% in 1960-61 to 10.4% in 1996-97 and 19.8% in April 2017 (24.6 Billion USD).

Shortcomings of Fiscal Policy

Fiscal policy of India suffers with some drawbacks which had prevented it from achieving the desired goals. Such drawbacks or shortcomings could be discussed under following headings:

Defective Tax Structure: Taxation is main source of revenue in the country. but our tax structure had been proved to be unsuitable as it had failed to raise the productivity of direct tax. Our tax system is not that elastic as it should be. It leads to tax evasion. Instances of tax evasion are increasing in the country leading to accumulation of black money in the economy. The country has been relying more on indirect tax which ultimately increases the burden of the poor.

Inflation: The fiscal policy of the country had failed to control the inflationary rise in price level. Policy of spending funds on non-development heads and relying on deficit financing and public debt had resultant into demand-pull inflation. On the other hand different kind of indirect tax on same product had increased price resulting in cost-pull inflation.

Red Tapism: Approval and implementation of fiscal policy measures is dependent on government. Lots of time is taken in approving as well as implementing any fiscal decisions. This delay may mitigate the impact of policy measure taken.

Negative Returns of Public Sector: Government is making huge investment in public sector. Inspite of that return on this investment is very low. May 2016, only 47 out of approx 2000 public companies that have reported their March quarter earnings, have earn quarter-on–quarter profit growth in the past four quarters.

Inadequate Statistics: For the formation of effective fiscal policy adequate and reliable data is needed from all over the country. Because of non-availability of accurate and adequate data, the measure of fiscal policy can neither be implemented nor can be judged properly.

Growing Inequality: The fiscal policy of the country had been failed to control growing inequality in the distribution of income and wealth. Inability to control tax evasion and high rate of indirect tax had affected the poor adversely.

Fiscal Policy for Limited Sector Only: Fiscal policy only affects few sector of the economy that too for monetary sectors. No effective fiscal policy is formed for non monetised sector of economy of developing country like India.

Suggestion for Reforms

Following are some reforms which are suggested for improvement in fiscal policies for developing countries in context to India:

Progressive Tax: The tax structure of the country must be progressive in nature so that burden may be put more on rich and less on poor. Necessary amendment must be made in this regard in various tax laws like Income Tax, Wealth Tax, Property Tax, etc.

Agriculture Tax: The tax law of the country should be extended to include agriculture from rich agriculturists. Tax on agriculture from upper income group farmers will also bring balance in tax structure of the country. It will reduce heavy dependence of tax revenue on indirect tax.

Reduction in Non Development Expenses: The fiscal policy should aim to reduce public expenditure especially in non development sector. The unproductive expenditure of the government must be identified and reduction effort must be made. Such reduction will also reduce the inflationary impact of such expenditure.

To Check the Black Money: The fiscal policy of the country must endure to check and reduce the black money circulating in the economy. Tax evasion, smuggling and other illegal monetary transaction must be curtailed down.

In November 2016, the Prime Minister, Shri. Narendra Modi announced demonetisation of currency notes of Rs 500 and Rs 1000 from the economy. Black money worth Rs 14,697 crore has been unearthed in the period of April to February 2016-17 against Rs 11,226 crore during the entire financial period of 2015-16. Black money worth Rs 5,400 crore was detected during tax raids from November 9, 2016 to January 10, 2017.

Raising the Profitability of Public Sector Units: The government through suitable fiscal policy; should try to restructure the management of Public Sector Enterprises. The efforts must be made to increase the efficiency and rate of return of capital invested. PSUs must be managed with specialists rather than with generalist with least government inference. Selection, appointed and training of personnel must be made on commercial lines.

Disinvestment in Public Sector Unit: India is plagued with inefficient public sector. Barring a very few, most of PSUs incurs heavy losses as compared with investment on them. It creates huge burden on the pockets of tax payers. Conceding the demands of privatisation and with tough resistance from labour unions, Government of India is slowly divesting from PSUs. In the Financial Year 2015-16 revised target of disinvestment was set at Rs 25,000 which was increased to 46,000 for year 2016-17.

Reduction of Pubic Debt: The fiscal policy should aim at reducing the public debt, internal as well as external. India recorded decrease in public debt in year 2016. Public debt was equivalent to 69.40% of GDP while it was 69.50% in 2015.

Reforms in Indirect Taxation: Fiscal policy of India had always incorporated reforms for indirect taxation. MODVAT was introduced to replace Central Excise Duty on certain items. Gradually it was extended to all commodities through Central Value Added Tax (CENVAT). Sales Tax was replaced by Value Added Tax. Goods and Services tax was introduced on July, 1 2017 in lieu of all indirect taxes payable on sale of goods and services. GST is so far the biggest tax reform in the country.

Fiscal Policy Review of Financial Year 2015-16

In 2015-16 the macroeconomic policy of the Government was aimed at building up on the reforms initiated in last year. The policy thrust was aimed at promoting growth revival as well as to foster a stable macroeconomic environment.

The Government had revised its expenditure policy to consolidate and focus on core developmental schemes. Simultaneously, measures were also taken to enhance the tax and non-tax revenues. The impact of twin measures both on macroeconomic and fiscal fronts had shown positive results. This is reflected by the higher trends of economic growth and stability along with an improved performance on all fiscal parameters.

Increase in GDP: The Indian economy as a consequence of series of measure has emerged as the fastest growing one amongst the large economies of the world. According to the advanced estimates of the Central Statistics Office, the growth in the GDP at constant market prices in 2015-16 is estimated at 7.6 per cent.

Reduction in structural Imbalances: The Government has taken proactive measures to reduce the existing structural imbalances both on the expenditure and the revenue fronts. On the expenditure side, measures were taken to enhance capital investments and control the growth in non-plan consumptive expenditure. On the receipts side also, measures were taken to enhance both the tax and non-tax revenues so as to counter balance the reduced share in the divisible pool of taxes.

Revised Expenditure Policy: The expenditure policy of the Government in 2015-16 reflects a continuance of the process of expenditure rationalization carried out with substantial correction on the revenue-capital expenditure imbalance. In budget of 2015-16, the total expenditure was estimated at 12.6 per cent of GDP compared to 13.3 per cent of GDP in 2014-15. The actual total expenditure has however been estimated to 13.2 per cent of GDP in 2015-16. However the actual increase in total expenditure over the budgeted estimates is only Rs.7,914 crore in nominal terms and 0.06 per cent as a ratio of GDP.

Improvement in Taxation Policy: In FY 2014-15, the gross tax to GDP ratio registered at 9.9 per cent, while in 2015-16 it was estimated at 10.3 per cent. The tax policy of 2015-16 was based on a more realistic growth estimation keeping in view the lower tax buoyancy in the previous years. As the result the gross tax to GDP ratio was estimated to increase further to 10.8 per cent of GDP at the end of 2015-16. A substantial increase on the indirect taxes through excise duty helped in not only compensating for the lower direct taxes collections, but also a marginal over achievement on gross tax revenues

Non Tax Revenues: Budget 2015-16 provided for an increase of 12.1 per cent in the non-tax revenues over the actual of 2014-15. It was aided with certain policy actions like enhancement of dividend rates to 30 per cent for all public sector enterprises and higher than estimated receipts under the Economic services. As the result the non-tax revenues are estimated to increase by 16.6 per cent over the budgeted estimates in 2015-16.

Total Receipts: Due to higher growths in both tax and non-tax receipts, total revenue receipts of the Centre has been revised upward in RE 2015-16 showing an increase of 5.7 per cent over BE 2015-16.

Disinvestment: Receipts from disinvestment (including strategic disinvestment) of Government stake in PSUs however continued to be lower than the budgeted estimates. It was budgeted at`69,500 crore in 2015-16. However, due to highly uncertain market conditions prevalent for most part of the year, this target has been revised downwards to 25,000 crore.

To summarize, the fiscal policy of the Government in 2015-16 has shown visible positive results. The capital expenditure of the Government as a percentage of total expenditure and the tax-GDP ratio is likely to be the highest since 2007-08. The non-tax revenues have also increased substantially over the budgeted estimates. This fiscal policy of the Government has contributed to support the macroeconomic objectives of promoting growth and stability in the economy.

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