Mains Practice Question

Q. Analyze the factors contributing to the fiscal deficit and suggest measures for fiscal consolidation while promoting inclusive growth. Also, briefly discuss the role of the FRBM Act in this context. **(250 words)**

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Approach:

- Introduce by defining fiscal deficit and need for fiscal consolidation
- Highlight factors contributing to the fiscal deficit
- Suggest measures for fiscal consolidation and inclusive growth
- Delve into the role of the FRBM Act
- Conclude positively.

Introduction

The **fiscal deficit** is a crucial economic indicator that measures the difference between the **government's total revenue and total expenditure.** India's FY24 fiscal deficit is **5.63%** of GDP.

- Fiscal deficit = Total Expenditure –Total Receipt (Excluding the borrowings)

Body:

Factors Contributing to the Fiscal Deficit:

- **Tax Revenue Shortfalls:** A narrow tax base due to the large informal sector and widespread **tax evasion/avoidance practices.**
    - In 2021-22, **3.5%** of the population paid income tax and this number dwindled further to **2.2% in 2022-23.**
    - Inefficient tax administration and enforcement mechanisms, leading to leakages in revenue collection.
- **Sticky Revenue Expenditure**: Rising burden of **interest payments on public debt** (Centre's FY25 interest outgo may rise 11 to 12% from ongoing FY24), driven by increasing borrowing costs.
    - **Ballooning subsidies** on food, fertilizers, and fuel, exacerbated by rising global prices and inefficient targeting.
- **Increasing Capital Expenditure:** Budgeted expenditure classified by the government as capex is projected to increase almost **4.5 times in 2024-25** to the level in 2014-15.
    - Ambitious **infrastructure development programs,** such as highways, railways, and urban infrastructure projects are the driving factors.
    - Defense modernization and procurement of advanced military hardware is also playing a key role.
- **Structural Rigidities: Rigid expenditure patterns** with limited flexibility to reallocate resources to productive sectors.
    - Lack of fiscal discipline **(exploitation of the exception clause of FRBM)** leading to overshooting of expenditure.
- **External Factors: Global economic slowdowns,** trade tensions, volatile international commodity prices, particularly for crude oil and other import-intensive commodities significantly

impact **India's import bill, trade balance, and fiscal position**.

A high fiscal deficit can have severe implications for the economy, including increased borrowing cost, higher interest rates, and a potential **crowding-out effect on private investment.**

- Therefore, **fiscal consolidation,** which involves reducing the fiscal deficit and maintaining sustainable debt levels, is essential for promoting inclusive growth and macroeconomic stability.

Measures for Fiscal Consolidation and Inclusive Growth:

- **Revenue Enhancement:** Broadening the tax base by **formalizing the informal sector and rationalizing tax exemptions**
    - Improving tax administration and compliance through technology-driven solutions.
- **Expenditure Rationalization:** Targeting subsidies through **better identification of beneficiaries and direct benefit transfers**
    - Prioritizing productive investments in education, healthcare, and infrastructure over non-productive expenditures.
- **Outcome-Based Budgeting:** Shift from traditional **input-based budgeting to outcome-based budgeting.** This approach allocates resources based on measurable goals and societal benefits.
- **Revamping the Fertilizer Subsidy Regime:** Shifting from a **product-based subsidy to a nutrient-based subsidy system**, coupled with measures to promote balanced fertilizer use, can reduce the fiscal burden and promote sustainable agricultural practices.

Role of the FRBM Act in Fiscal Consolidation:

The FRBM Act, introduced in 2003, plays a crucial role in fiscal consolidation by mandating the government to follow a rules-based fiscal policy framework. The key objectives of the FRBM Act include:

- Setting targets for the **elimination of revenue deficit** and **reduction of fiscal deficit** to a sustainable level.
- Establishing a **medium-term fiscal policy statement** with three-year rolling targets for specific fiscal indicators.
- Promoting transparency in fiscal operations through regular reporting and disclosures.

Conclusion:

- There is a need to enhance the credibility and enforceability of the Fiscal Responsibility and Budget Management Act through limited **escape clauses, binding targets, and an independent monitoring mechanism** that can promote **fiscal discipline** and inclusive growth.