



## 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.