1. It is important for India to return to the path of fiscal consolidation while also increasing public investment. Explain why achieving both these objectives are important to revive the present economic environment in the country. (12.5 Marks)

Answer:

Fiscal consolidation (FC) means reducing fiscal deficit (FD) by reducing public expenditure and/or increasing the revenue. The aim is to discipline the public finances and is enjoined by the FRBM Act, 2003 (which intends to cap the Fiscal deficit to 3% of GDP). Public investment means committing public money to various socio economic objectives. It is often seen that public investment is curtailed to cater the needs of fiscal consolidation. Both these objectives have been contested, with arguments on both the sides.

Fiscal Consolidation (FC)

A. Significance

- Large FD means government as the major borrower leaving private sector short of credit for investment.
- High ED adds to interest burden on the government, thereby diverting the money from productive sectors. At present, interest payments at the Union level, account for almost 50% of their net tax revenues.
- High FD increases the interest rates in the economy, thereby fuels inflation.

Therefore, the importance of FC can't be overstated. Hence, the credit rating agencies consider FD as an important variable to assess the credit worthiness of an economy.

B. Argument against

During economic slowdown, the government has to incur deficit to boost the economy. When the aggregate demand is already low, adhering to the path of FC is counter-productive. For example, during 2008 crisis we have to abandon the targets under FRBM Act. To look into this issue further, NK Singh Committee has been set up by Finance Ministry.

Public Investment

A. Significance

- Public investment in productive sectors acts as the stimulator, fueling demand and hence growth in the economy. It is particularly important in current scenario of sluggish growth.
- At present, capital expenditures is merely 1.7% of GDP which means lesser future growth. Public investment in infrastructure would boost future growth and consumption in the present.
- It has domino effect as it crowds in the private investment, which, at present, is significantly depressed.
- Private investment is volatile and it being majorly in form of FDI and FII is prone to global risks and hence more volatile.

- Private investment in India has been in capital intensive sectors like services. Hence, to boost employment growth public investment is needed.
- Public investment is necessary to bridge the sectoral and regional inequalities.

B. Challenges

- Increased public investment may crowd out private investment.
- It is difficult to mobilize resources for investment in current slowdown.

Way forward

We have to find balance between these apparently conflicting objectives a under:

- Reprioritize expenditure, with greater focus on the productive capital expenditure and reducing revenue expenditure.
- Rationalize subsidies to increase fiscal space.
- Divest government's stakes held in specified PSUs arid utilize these resources for capital investment.
- In line with Vijay Kelkar Committee's report on PPP, we should resolve the stuck investment projects and revive the PPPs.
- As suggested by FFC, there should be an independent Fiscal council to monitor the implementation of fiscal rules by the government.
- The implementation of a well-designed Goods and Services Tax (GST) and other tax reforms would also play the crucial role in enhancing revenues.
- Exploring feasibility of having a 'fiscal deficit range' as the target in place of the existing fixed numbers (percentage of GDP) as fiscal deficit target.

PRACTICE QUESTIONS

Answer the following Questions (12.5 Marks)

1. Although it is the right time for elevating the mission of 'Make in India' to 'Innovate in India', significant challenges exist in doing so. Elaborate. How can these challenges be overcome?
2. What is meant by public debt? Highlight the objectives of public debt management. Explain why it is considered prudent to disaggregate debt management from monetary policy and take it out of the realm of central bank.