to adhere to the path of fiscal consolidation (although exceptional situations like the 2008 crises allow the government to take exceptional measures).

Achievements of the Act

- Brought centrality to the issues relating to fiscal consolidation as the government has to mandatorily present medium-term and strategy statements annually.
- Sustained high FDs raise the debt-GDP ratio and increase interest payments as proportion of revenue.
- It improved the fiscal performance of both centre and states, which has contributed to their economic stability, as reflected in controlled inflation in the past year.
- Performance on controlling fiscal deficit has been an important factor deciding sovereign debt ratings. Adherence to consolidation has helped us from being downgraded.
- Strict adherence to the path of fiscal consolidation during pre-crisis period created enough fiscal space for pursuing counter cyclical fiscal policy.

However, fixing a blanket target for fiscal deficit has been debatable. It is argued that, if the bank credit to the economy does not adequately grow, economic growth will suffer for want of money. Government expenditure must fill the gap in such situation, the consequence of which is rise in fiscal deficit. The economic slowdown since 2012 can partly be attributed to reduced money supply since. Further, the restrictions placed by the FRBMA have constrained the ability of the state to fill the expenditure gap.

The Finance Minister has recently suggested that fiscal expansion or contraction should be aligned with credit (money supply) contraction or expansion respectively. That is, if credit growth falls, fiscal deficit may needs to rise and vice-versa to ensure adequate money supply to the economy. FRBMA in its current form ignores this possibility and therefore, it is appropriate to get it reviewed.

10. 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.

Approach:

- Defining fiscal consolidation, discuss its significance for economic stability.
- Discuss the significance of public investment.
- Discuss the underlying challenges in balancing the two and suggest measures for the same.

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.

Student Notes: