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Fiscal management and economic growth of India during global crises period

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Abstract

This paper investigates the relationship between public sector financial management and economic growth in India during global crisis period. The main objectives of this paper are: To study the role of India's fiscal management policy in economic growth during global crisis period, to examine the impact of fiscal stimulus packages on India's fiscal management during global crisis period and to examine the effectiveness of fiscal management policy measures taken by Indian government to counter the effects of global crisis on Indian economy. It is found that the GDP growth in India shows continuously rising trends during 2004-05 to 2006-07 i.e. 7.5 percent in 2004-05 which goes up to 9.7 percent in 2006-07, during globalization period it goes down 9.3 percent in 2007-08 and 6.7 percent in 2008-09. It means India's economy is affected by Global financial crisis since mid of 2007. The fiscal policy measures had taken by government to counter the effect of global economic slowdown on the Indian economy. Fiscal policy of 2008-09 cuts the excise duty, customs duty and service tax to increase the demand for industrial goods. Due to these measures India's GDP growth increases from 6.8 percent of 2008-09 to 7.74 in 2009-10 and 8 percent in 2010-11. India's Fiscal Deficit was 4.5 percent in 2003-04 which goes down at lowest 2.5 percent in 2007-08. After global crisis period the fiscal stimulus packages of expenditure and tax cuts during global crisis period fiscal deficit increased from 2.5 percent of GDP in 2007-08 to 6.3 percent in 2009-10. The fiscal policy of 2011-12 will continue to be guided by the principles of gradual adjustment from the fiscal expansion undertaken during the global crisis period in 2008-09 and 2009-10. It may be seen that the fiscal deficit is estimated at 5.1 percent and 4.6 percent of GDP as against 5.7 percent and 4.8 percent in 2010-11 and 2011-12 respectively.

Keywords: Fiscal Management, Economic Growth, Global Crises

Introduction

The effective management of public expenditure is an integral part of the fiscal consolidation process. Expenditure has to be oriented towards the production of public goods and services. The extant classification of public expenditure between plan, non-plan, revenue and capital spending needs to be revisited. This is necessary as one recognizes the importance of service sector and the knowledge economy for our development. A Committee under Dr. C. Rangarajan has been set up by the Planning Commission to look into these issues. Fiscal policy has to decide on the size and pattern of flow of expenditure from the government to the economy and from the economy back to the government. So, in broad term fiscal policy refers to "that segment of national economic policy which is primarily concerned with the receipts and expenditure of central government." In other words, fiscal policy refers to the policy of the government with regard to taxation, public expenditure and public borrowings. The importance of fiscal policy is high in underdeveloped countries. The state has to play active and important role. In a democratic society direct methods are not approved. So, the government has to depend on indirect methods of regulations. In this way, fiscal policy is a powerful weapon in the hands of government by means of which it can achieve the objectives of development.

Fiscal policies have a benign role for economic growth in the Asian region, namely to provide a stable macro environment for investment. The changed environment of liquidity constraints on external borrowing and slowdown in output growth has led to new attention being directed towards the role and contribution of fiscal policies in reviving growth in the region (Gangopadhyay, Chatterji. 2005). In the debate on economic policy, fiscal policy is predominantly viewed as an instrument to mitigate short-run fluctuations of output and employment. By a varying government spending or taxation, fiscal policy aims at altering aggregate demand in order to move the economy closer to potential output. Fiscal policy was neither a cause of the crisis nor a critical determinant of economic growth. Nevertheless, its role in both the pre-crisis and post-crisis period in Indian economy has been seen as crucial, primarily in terms of its contribution to economic growth. From the view of the perspective of contemporary debate in the pre-crisis decade, policy concerns focused on the perceived overheating of India economies rather than concerns with fiscal and external sustainability.

Objectives and methodology

This paper investigates the relationship between public sector financial management and economic growth in India during global crisis period. The main objectives of this paper are: To study the role of India's fiscal management policy in economic growth during global crisis period, to examine the impact of fiscal stimulus packages on India's fiscal management during global crisis period and to examine the effectiveness of fiscal management policy measures taken by Indian government to counter the effects of global crisis on Indian economy. The data regarding fiscal indicators and economic growth in India were collected for the period from 2005-06 to 2010-11. The data for the study was obtained from

World Bank Statistics available on World Bank websites, IMF statistics from IMF websites and various publications of the Reserve Bank of India, Economic Surveys of India, Union Budgets of India, Government of India's Central Statistical Organization and from Ministry of Finance, Government of India and Controller General of Accounts. The collected data were analyzed to establish the relation between fiscal management and economic growth during global crisis period.

Review of Literature

The most recent empirical literature, mainly based on panel data regressions, show that economic growth is significantly affected by fiscal policies, although there remains some lack of agreement on the sign of the effects (Gerson, 1998) [2]. Caselli, (1996) [3] found robust positive contribution of the government expenditure ratio to growth. Jermainlam, (2002) [4] revealed that the Asian financial turmoil has fully exposed the weaknesses of the fiscal management philosophy and practices adopted in Hong Kong. Perhaps the doctrines of "positive non-intervention" and "prudent fiscal management with a surplus budget" are in the strictest sense outmoded in an age of globalization. Chery, Tracey Aristomene, (2009) [5] stated that the Fiscal Policy and Economic Growth have positive implications for competitiveness and growth in the economy. A shift away from direct toward indirect taxes was noticeable in most cases analyzed. In some countries, such as the Slovak Republic, this was a conscious policy decision and is likely to have a positive influence on economic growth. Nwezeaku (2010) [6] in his study indicated that a significant relationship existed between public sector financial management and economic development of the countries under study with the management of inflation, government revenue and government expenditure causing the greatest worry for both Nigeria, Ghana, Hussin, Muzafar, Ahmad, (2009) [6-7] stated that the fiscal policy is one of the most important instruments of government economic policy to establish the relationship between fiscal policy and economic growth.

Studying the relationship between government expenditure and economic growth is becoming of crucial importance to divide government activities in several categories and methodologies. Zagler, Dürnecker (2003) [10] surveyed the literature on fiscal policy and economic growth. They presented a unifying framework for the analysis of long run growth implications of government expenditures and revenues. They found that the level of education expenditure and the growth rate of public infrastructure investment both exhibited a positive impact on the growth rate of the economy. Tanzi, Zee (1997) [8] examined systematically the various ways that the main fiscal instruments (tax policy, public expenditure policy, budget policy) influenced economic growth through their impact on the determinants of growth. Yasin (2003) studied the relationship between government expenditure and economic growth. His studies re-examined the effect of government spending on economic growth using panel data set from Sub-Saharan Africa. The results from both estimation techniques indicated that government spending, trade-openness, and private investment spending all had positive and significant effect on economic growth.

Objectives of India's Fiscal Policy

The objectives of fiscal policy such as economic development, price stability, social justice, etc. can be achieved only if the tools of policy like Public Expenditure, Taxation, Borrowing and deficit financing are effectively used. Though there are gaps in India's fiscal policy, there is also an urgent need for making India's fiscal policy a rationalized and growth oriented one. The success of fiscal policy depends upon taking timely measures and their effective administration during implementation. The deadly combination of a high inflation and interest rates, and rupee depreciation, will take a toll on the fiscal and current account deficits.

Fiscal Policy of India

As opposed to monetary policy, fiscal policy refers to expenditure, taxation and government borrowing. The main point of fiscal policy is to keep the surplus or deficit swings in the economy to a minimum by reducing inflation and recession.

There are two types of expenditures – money spent on the delivery of goods and services and the transfer of funds to other levels of government. Government expenditure can be both, planned, as well as non-planned. Planned capital expenditure is like government expenditure on social sectors and planned non-capital expenditure means normal government expenses. Taxation takes many forms (direct and indirect), including taxation of personal and corporate income, so-called value added taxation and the collection of royalties or taxes on specific sets of goods. Government revenue is categories into revenue receipts non-revenue receipts and capital receipts. Through borrowing, a government means to provide a great deal of goods and services to its people, while not having the immediate tax revenue to fund that expenditure. Primarily issuing securities, such as Treasury Bills or Treasury Bonds, does this. All levels of government borrow money at some point or the other. Fiscal Policy has two main tools – the changing of tax rates, and changing of government expenditure. The government has been focusing on both of these to provide a boost to the economy.

Fiscal policy can work in two general ways to stabilize the business cycle. One way is through automatic stabilizers, which arise from parts of the fiscal system that naturally vary with changes in economic activity. Discretionary fiscal policy, on the other hand, involves active changes in policies that affect government expenditures, taxes, and transfers and are often undertaken for reasons other than stabilization (IMF, 2008). By their nature, automatic stabilizers play an immediate role during downturns. But they are usually by-products of other fiscal policy objectives. As such, the size of automatic stabilizers tends to associated with the size of government (Fatas, Antonio, Mihov, 2001) [11].

Indian fiscal policy overview during crises period

The Union Budget 2008-09 was presented in the backdrop of impressive growth in the Indian economy which clocked about 9 per cent of average growth in the last four years. This striking performance coupled with significant improvement in fiscal indicators, during the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 regime definitely put the country on a higher growth trajectory inspiring confidence in the medium to long term prospects of the economy. The process of fiscal consolidation during these years has resulted in improvement in fiscal deficit from 5.9 per cent of GDP in 2002-03 to 2.7 per cent of GDP in 2007-08. During the same period, revenue deficit has declined from 4.4 per cent to 1.1 per cent of GDP. Due to global financial crises fiscal deficit 2.5 percent of GDP in 2007-08 goes up to 6 percent of GDP in 2008-09 and which has estimated 4.8 percent of GDP in 2010-11. During the same period, revenue deficit has increased 1.1 per cent of GDP to 4.5 percent of GDP and has estimated 3.5 percent of GDP in 2010-11.

Fiscal position of India during global crises period

As the crisis impacted the economy in the second half of 2008-09, movements in quarterly estimates of the demand side of the GDP provided better indication of the recovery process and thus the Budget for 2010-11 envisaged a partial exit from the stimulus measures on the strength of the outcome of the second quarter of 2009-10. This response was broadly in line with the international practices in this regard, which had preferred fiscal policy instruments for counteracting the adverse economic impact of the crisis. In actual terms, the Budget for 2010-11 had estimated the level of fiscal deficit at ` 3,81,408 crore and revenue deficit at 2,76,512 crore. At the time of presentation of the Budget for 2010-11 it was envisaged that nominal GDP (GDP at current market prices) would grow by 12.5 per cent and was estimated at 69,34,700 crore. As proportions of the nominal GDP, fiscal and revenue deficits were estimated at 5.5 per cent and 4.0 per cent respectively. As per the advance estimates (AE) released by the Central Statistics Office (CSO) on 7 February 2011, the nominal GDP for 2010-11 was placed at ` 78,77,947 crore, which represents a year-on-year growth of 20.3 percent, and was 7.8 percentage points higher than envisaged at the time of Budget formulation. As proportions of the GDP as per the AE, budgeted fiscal and revenue deficits work out to 4.8 per cent and 3.5 per cent for the current fiscal. Thus, as proportions of the GDP, the recent trends in deficit indicators, post-crisis, have been influenced to some extent by the swings in the levels of aggregate demand.

Central Government Finances during Global Crises Period

The key driver of the rapid fiscal consolidation after the notification of the FRBM Rules in July 2004 was the buoyancy in tax revenues. As a proportion of the GDP, gross tax revenue rose from a level of 9.2 per cent in 2003-04 to reach a peak level of 11.9 per cent in 2007-08; after falling to 10.8 per cent and 9.6 in 2008-09 and 2009-10 respectively, it was estimated to recover to 10.8 per cent in 2010- 11 (BE) as per the then estimated levels of GDP. However, as a proportion of the GDP as per the advance estimates of the CSO, it is at 9.5 per cent. Two significant developments in the recent past in terms of the composition of taxes have been the growth in direct tax revenues, particularly corporate income tax, and in service tax revenues. Union excise duties that have traditionally been the single largest revenue earner ceded place to corporate income tax in 2006-07. In 2009-10, owing to the fiscal stimulus package which envisaged significant reduction in duties and a demand slowdown, union excise duties declined substantially. In 2010-11, with partial restoration in rates and surge in demand, union excise duties have done exceedingly well. With continuance of high growth in corporate income tax and a higher than budgeted outcome in personal income tax in the current year, the prospects of revenue-led medium-term consolidation appears bright.

India's fiscal deficit during crises period

India's Fiscal Deficit was 4.5 percent in 2003-04 which goes down at lowest 2.5 percent in 2007-08. After global crisis period it increased up 6.3 percent in 2009-10. It is recovered in 2010-11 and stood at 4.8 percent due to fiscal measurements taken by central government during crisis period. The revenue deficit was as lowest as 1.1 percent in 2007-08 which increased up 5.1 percent in 2009-10 due to fiscal management such as increase in excise duties and service tax it goes does and stood at 3.5 percent in 2010-11. Primary deficit was almost zero percent of GDP in 2003-04 & 2004-05 which rose up to 3.1 percent in 2009-10 due to global crisis. The fiscal management measures taken by central government the primary, fiscal and revenue deficit goes down during financial year 2010-11. The fiscal policy of 2011-12 will continue to be guided by the principles of gradual adjustment from the fiscal expansion undertaken during the global crisis period in 2008-09 and 2009-10. It may be seen that the fiscal deficit is estimated at 5.1 percent and 4.6 percent of GDP as against 5.7 percent and 4.8 percent in 2010-11 and 2011-12 respectively (table no.1).

In actual terms, the Budget for 2010-11 had estimated the level of fiscal deficit at ` 3,81,408 crore and revenue deficit at 2,76,512 crore. At the time of presentation of the Budget for 2010-11 it was envisaged that nominal GDP (GDP at current market prices) would grow by 12.5 per cent and was estimated at

Table 1: Trends in Deficits of Central Government

Years	Revenue Deficit	Fiscal Deficit	Primary Deficit	Revenue Deficit as Percentage to Fiscal Deficit
2003-04	3.6	4.5	0.0	79.7
2004-05	2.4	3.9	0.0	62.3
2005-06	2.5	4.0	0.4	63.0
2006-07	1.9	3.3	-0.2	56.3
2007-08	1.1	2.5	-0.9	41.4
2008-09	1.5	6.0	2.6	75.2
2009-10(P)	5.1	6.3	3.1	80.7
2010-11(BE)	3.5	4.8	1.7	72.5

Source: Union Budget documents.

69,34,700 crore. As proportions of the nominal GDP, fiscal and revenue deficits were estimated at 5.5 per cent and 4.0 per cent respectively. As per the advance estimates (AE) released by the Central Statistics Office (CSO) on 7 February 2011, the nominal GDP for 2010-11 was placed at ` 78,77,947 crore, which represents a year-on-year growth of 20.3 per cent, and was 7.8 percentage points higher than envisaged at the time of Budget formulation. As proportions of the GDP as per the AE, budgeted fiscal and revenue deficits work out to 4.8 per cent and 3.5 per cent for the current fiscal. Thus, as proportions of the GDP, the recent trends in deficit indicators, post-crisis, have been influenced to some extent by the swings in the levels of aggregate demand.

Global Prospects and Policy during Crises Period

For four years through the summer of 2007, the global economy boomed. Global GDP rose at an average of about 5 percent a year, its highest sustained rate since the early 1970s. About three-fourths of this growth was attributable to a broad-based surge in the emerging and developing economies. Over the past year, the global economy has been buffeted by the depending crisis in financial markets, by major corrections in housing markets in a number of advanced economies, and by surges in commodity prices. Indeed, the financial crisis that erupted in August 2007 after the collapse of the United States sub-prime mortgage market entered a tumultuous new phase in September 2008 that has badly shaken confidence in global financial institutions and markets. Most dramatically, intensifying solvency concerns have triggered a cascading series of bankruptcies, forced mergers, and public interventions in the United States and Western Europe, which has resulted in a drastic reshaping of the financial landscape (IMF, 2008).

The global financial and economic crisis keeps getting worse. A couple of weeks back the giant city bank had to be bailed out with several hundred billion dollars in cash and guarantees from the US authorities. In July 2008, the IMF foresaw stated that the world economy growing at 3.9 percent in 2009, advanced economies at 1.4 percent and developing countries at 6.7 percent. April 2009 IMF forecasts had been slashed down to minus 1.3 percent, minus 3.8 percent and 1.6 percent respectively. According to January 2012 IMF forecasts the world economic growth was 5.3 percent in 2010 and 3.8 percent in 2011it was 3.2 and 1.6 for advanced economies and 7.3 and 6.2 for emerging economies during 2010 and 2011. January 2012 IMF forecasts had projected world economic growth 3.3 percent in 2012 and 3.9 percent in 2013it was 1.2 and 1.9 for advanced economies and 5.4 and 5.9 for emerging economies during 2012 and 2013(table no. 2).

Table 2: Global Economic Outlook (percent)

Indicator	Month of Forecast									
	Jul-2008	Nov-2008		Jan-2009			Apr-2009		Jan-2012	
	2008	2009	2008	2009	2008	2009	2008	2009	2010	2011
1. Global Growth	4.1	3.9	3.4	0.5	3.4	0.5	3.2	-1.3	5.2	3.8
(a) Advanced Economies	1.7	1.4	1.0	-2.0	1.0	-2.0	0.9	-3.8	3.2	1.6
(b) EMEs	6.9	6.7	6.3	3.3	6.3	3.3	6.1	1.6	7.3	6.2

Source: World Economic Outlook various issues, I.M.F.

Indian Economic Outlook

The overall impact of global economic slowdown on India would, however, be minimal as the factors driving growth here are more local in nature. Unlike the rest of Asia, India is a strong domestic demand story, so any slowing in the US is likely to have a more muted impact on India. Strong growth in domestic consumption and significant spending on infrastructure are the two pillars of India's growth story. No sector has a dominant influence on earnings growth and risks to our estimate are limited. The Central Statistical Office released the quick estimates of national income, consumption expenditure, saving and capital formation for 2010-11 today. Savings and investment data for 2010-11 are new and all other data are revisions to earlier releases. GDP at factor cost at constant (2004-05) prices (real GDP) grew by 8.4 per cent in 2010-11. This growth was at the same level of 8.4 per cent in 2009-10. (As per earlier data real GDP growth was 8.5 per cent and 8.0 per cent in 2010-11 and 2009-10). Demand side GDP at constant market prices grew by 9.6 per cent in 2010-11 over a level of growth of 8.2 per cent in 2009-10. Agriculture and Allied sector registered a growth of 7.0 per cent in 2010-11 as against 1.0 per cent in 2009-10. The rate of growth of industry and services sector was 7.2 per cent and 9.3 per cent respectively for 2010-11. The growth rate for these sectors was 8.4 per cent and 10.5 per cent respectively in the year 2009-10.

GDP Growth in India during Global Crisis Period

Gross domestic product is the main indicator of the growth prospects of the country. In January 2009 policy review of India projected growth for 2008-2009 of 7.1 percent with a downward bias. GDP growth rate at constant prices in the year 2008-2009 is 6.7 percent as against 7.1 percent in the advance estimated over the quick estimates of GDP for the year 2007-08. The downward revision in the GDP growth rate is mainly on account of lower performance in almost all the sectors excluding construction, community, social and personal services than anticipated.

Table no. 3 indicates that the growth rate of GDP in India was 9.0 percent in 2007-08, which goes down at 6.7 percent in 2008-09 (table no.4). This downturn in growth rate was

Table No. 3: GDP Growth in India during Global Crisis Period. (Percentage to GDP)

Particulars	2007-08	2008-09	2009-10	2010-11	2011-12
Agriculture, forestry & fishing	4.9	1.6	0.2	3.7	3.6
Mining & quarrying	3.3	3.6	10.6	7.7	-0.5
Manufacturing	8.2	2.4	10.8	9.1	4.9
Electricity, gas & water supply	5.3	3.4	6.5	4.1	8.9
Construction	10.1	7.2	6.5	7.2	2.7
Trade, hotels & restaurants	10.1	N.A.	9.3	11.11	11.13
Transport storage & communication	15.5	N.A.		N.A.	N.A.
Financing, insurance, real estate &	11.7	7.8	9.7	9.9	9.8
Business services					
Community, social & personal services	6.8	13.1	5.6	8.0	6.1
Total GDP at factor cost	9.3	6.8	7.4	8.0	7.3

Source: Central Statistical Organization.

mainly due to downturn growth in agriculture and allied sector 1.6 percent form 4.9 percent, manufacturing 2.4 percent from 8.2 percent, construction 7.2 percent from 10.1 percent and finance and insurance 7.8 percent from 11.7 percent over previous year. GDP growth in India shows continuously rising trends during 2004-05 to 2006-07 i.e. 7.5 percent in 2004-05 which goes up to 9.7 percent in 2006-07, after that this goes down 6.8 percent in 2008-09. It means India's economy is affected by Global financial crisis since mid of 2007. During 2009-10 the GDP growth in Indian was goes up to 7.4 percent and it was 8 percent in 2010-11 this increase was due to stimulus fiscal and monetary policy adopted by central government during these years. During European crisis period Reserve Bank of India adopted tight monetary policy by increasing interest rates for controlling inflation rate and central government adopted tight fiscal policy during this period. Due to this tight fiscal and monetary policy the growth of India goes down up to 7.3 percent in 2011-12. This downturn in growth rate was mainly due to downturn growth in Mining & quarrying sector -0.5 percent from 7.7 percent, manufacturing 4.9 percent from 9.1 percent, construction 2.7 percent from 7.2 percent and Community, social & personal services 8 percent from 6.1 percent over previous year.

Conclusion

It is found that the GDP growth in India shows continuously rising trends during 2004-05 to 2006-07 i.e. 7.5 percent in 2004-05 which goes up to 9.7 percent in 2006-07, during globalization period it goes down 9.3 percent in 2007-08 and 6.7 percent in 2008-09. It means India's economy is affected by Global financial crisis since mid of 2007. The fiscal policy measures had taken by government to counter the effect of global economic slowdown on the Indian economy. Fiscal policy of 2008-09 cuts the excise duty, customs duty and service tax to increase the demand for industrial goods. Fiscal policy of 2009-10 will continue to counter the effects of global slowdown by creating demand through increased public expenditure in identified sectors. This fiscal stimulus package increases the demand for industrial and service sector goods. Due to these measures India’s GDP growth increases from 6.8 percent of 2008-09 to 7.74 in 2009-10 and 8 percent in 2010-11. During 2010-11 Reserve Bank of India adopted tight monetary policy by increasing interest rates for controlling inflation rate and central government adopted tight fiscal policy by increasing excise duties during this period. Due to this tight fiscal and monetary policy the growth of India goes down up to 7.3 percent in 2011-12.

India’s Fiscal Deficit was 4.5 percent in 2003-04 which goes down at lowest 2.5 percent in 2007-08. After global crisis period the fiscal stimulus packages of expenditure and tax cuts during global crisis period fiscal deficit increased from 2.5 percent of GDP in 2007-08 to 6.3 percent in 2009-10. It is recovered in 2010-11 and stood at 4.8 percent due to fiscal measurements taken by central government during this period. The revenue deficit was as lowest as 1.1 percent in 2007-08 which increased up 5.1 percent in 2009-10 due to fiscal management such as stimulus packages it goes down up to 3.5 percent in 2010-11 due to fiscal management such as increase in excise duties and service tax it goes down and stood at 3.5 percent in 2010-11. Primary deficit was almost zero percent of GDP in 2003-04 & 2004-05 which rose up to 3.1 percent in 2009-10 due to global crisis. The fiscal management measures taken by central government the primary, fiscal and revenue deficit goes down during financial year 2010-11. The fiscal policy of 2011-12 will continue to be guided by the principles of gradual adjustment from the fiscal expansion undertaken during the global crisis period in 2008-09 and 2009-10. It may be seen that the fiscal deficit is estimated at 5.1 percent and 4.6 percent of GDP as against 5.7 percent and 4.8 percent in 2010-11 and 2011-12 respectively.

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