Responsiveness of Fiscal Consolidation for Steady Growth in India and Sri Lanka

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Fiscal policy and fiscal reforms have a dynamic impact on the growth process. It has been empirically established in the post monetarist, endogenous growth theories, that productive expenditures and non-distortionary taxes positively affect long run growth. Macro adjustment theories based on IS-LM framework emphasized upon the effectiveness of fiscal policy through various fiscal instruments. 1990s onwards, as increasing number of countries started facing fluctuations and crisis in terms of growth rate, budget deficits, current account deficits, exchange rate, inflation, investment, savings and countries started adopting rules based reforms along with public sector restructuring, tax reforms and expenditure reprioritization. IMF (2015) emphasizes that fiscal reforms in developing countries contribute more towards growth as compared to developed nations. In these countries fiscal consolidation is a pre condition for growth, given their levels of deficit compulsions. Recent literature puts more emphasis on fiscal consolidation process through deficit and debt sustainability and hence macro stability. Fiscal consolidation process in India and Sri Lanka exhibits a contractionary approach, though Sri Lanka appears with better fiscal ratios and stable GDP growth. Panel regression estimations revealed a weak relationship between public debt to GDP ratio as dependent variable and GDP growth, tax revenues and inflation and capital expenditure as independent variable. Although both the countries have been successful in reducing their fiscal deficit and hence public debt to GDP ratios, this has been at the cost of reducing capital expenditures only. Interest payments and tax revenues. Which have theoretically been proven as the significant determinants of public debt reduction process, appear to be non-responsive in the ongoing fiscal consolidation. The fiscal sustainability indicators approach indicates the weakness of the fiscal rules based policy being aggressively adopted by both the countries.

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