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FISCAL POLICY AND STABILISATION

- Scope for the topic given to us is
 - Ability of fiscal policy to stabilise economic fluctuations.
 - Debt and deficits with focus on lessons from Greek crisis.
 - Potential environmental taxes in india
 - Prospects of increasing sin taxes



FISCAL POLICY

- It is basically use of revenue collection and expenditure by the government to influence the economy.
- Fiscal policy is largely based on the ideas of British economist John Maynard Keynes (1883–1946)
- Fiscal policy is often administered by an executive under laws of a legislature, while monetary policy deals with the money supply, lending rates and interest rates and is often administered by a central bank.



NEED FOR FISCAL POLICY

- Economic instability In free market economy.
- At times of the Economic fluctuations and Business Cycle
- At times the economy is ‘overheated.
- ‘Need for Stabilization Policy‘



MANY STANCES OF FISCAL POLICY

- Neutral fiscal policy
- Expansionary fiscal policy
- Contractionary fiscal policy



DISCRETIONARY AND NON-DISCRETIONARY FISCAL POLICY

There are two types fiscal policy

- non-discretionary fiscal policy, an automatic stabilizers. it is a built-in tax or expenditure mechanism
- By discretionary policy we mean deliberate change in the Government expenditure and taxes to influence the level of national output and prices.



IMPORTANT GOALS OF FISCAL POLICY

- Economic stability.
- Ensuring price stability.
- Economic growth.



MAIN TOOLS OF FISCAL POLICY

- Fiscal policy is mainly a policy of demand management.

There are two fiscal methods to deal with recession or boom in economy.

- (a) Government Expenditure
- (b) Taxes.



GREEK CRISIS



- Since Mid 1990s, Greece spending more than tax collection
- In 2009, newly elected government showed the fiscal mismanagement of previous govt.

Data on govt debts and deficits was misreported

Fiscal deficit reported 13.6 in 2007-08



- Global community had doubts over Greece's ability to repay the debt
- Crisis of confidence and uncertainty
- Borrowing costs rose sharply (fiscal deception)
 - In 2012 Greek defaults on repayment of sovereign debt by not repaying IMF loan
 - Two bailouts; making only French/German banks safe



- Reforms: High Tax collection and reduced govt spending leading to slow economic recovery (unemployment rate at 25% mainly youth)



HOW THE CRISIS DEVELOPED

- Joining Eurozone
- Reduction in trade cost
- Increase in labour cost
- Greek exports became uncompetitive
- Capital account deficit rose
- Increased govt borrowing leading to high fiscal deficit and public debt over years (mainly hidden from public eye)



- 2008 global financial crisis
- Funds from across the globe dried up
- Main economic sectors like shipping and tourism hit hard
- A country facing ‘sudden stop’ in private investment and high public debt typically allows currency depreciation; option not available to Euro members



POSSIBLE RESPONSE

- Bailouts (short term)
- Improving competitiveness (Long Term)
- Efficient Management of Public Finance
- Statistical/Information credibility



LESSON LEARNT

- For a globally integrated economy with open capital account, statistical/information credibility is important for economic health
- When economy is booming, risk taking ability of the economy increases irrationally leading to ultimate economic burst/crisis
- As per Reinhart and Rogoff, the growth prospects of an economy hit hard when public debt to GDP ratio goes beyond one.





POTENTIAL OF ENVIRONMENTAL TAXES IN INDIA

- An **environmental tax** is a **tax** whose base is a physical unit (or a proxy of a physical unit) of something that has a proven, specific negative impact on the **environment**.
- Levied to discourage behaviour that is potential harmful to environment
- Powerful incentive to reduce emissions and fight climate change
- Possible solution to many environmental problems
- Has economic and social potential
- Providing human right on healthy environment that is constantly violated in conditions of market economy
- Four main categories: energy, transport, pollution, resources taxes



- Huge subsidy on petrol/diesel
- Recent steep decline in oil price
- Opportunity
 - Rid of distorting subsidies (fiscally prudent)
 - Shifting taxes towards carbon use (potent instrument of climate change)

Decontrol diesel price and increasing **excise duty on petrol/diesel** periodically to match the declining global prices

Implicit carbon tax

More fuel = Greater emission = More tax

From negative price to positive price on C emissions



INDIAN CONTEXT

- Polluter pay principles (Kamal Nath case)
- Precautionary principles (Oleum gas leak case)
- International treaties/ negotiations
- Global responsibility
- Sustainable development



- Since Oct 2014, \$60& \$42 per ton of petrol/ diesel (Tax)
 - 11 million tons (0.6% of India's annual) tons of CO2 reduction per year
- Coal cess increased from Rs 50 to Rs 100 to Rs 200 per ton
 - Rs 17000 crores so far

Carbon subsidy to carbon taxation regime :: increased price and decreased emissions

Green tax eg. Manali Municipal corporation, Rohtang pass

- ✓ Access of energy to the poor,
- ✓ Equalises marginal social damage so as to internalise social costs
- ✓ Revenue for activities related to environmental taxes
- ✓ Additional revenue by removing subsidies

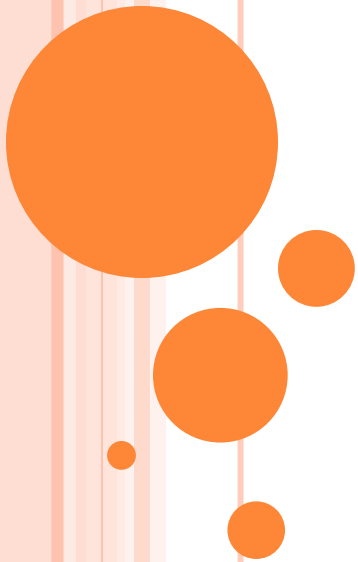


- Environmental taxes should be accompanied by reduction in other taxes for balancing the tax loading on enterprises
- Necessary compromise between the preservation of cost of production and increase interest in reducing emissions of CO₂ and GHGs



SIN TAX

Prospect of increasing sin tax to increase the revenue and curb the socially harmful and unethical activities



- "Sin taxes" are taxes imposed on products or services that are viewed as harmful to the society.
- For example tobacco, liquor and gambling.
- Govt's move to discourage use of such things.
- People hesitate in questioning such levies.
- Liquor provides 20 per cent of the share of the government's own revenue in most States.



RESULTS FROM A CASE STUDY

- Raising bidi taxes to Rs 98 per 1000 sticks would add Rs 36.9 billion to tax revenues and prevent 15.5 million current and future smokers dying prematurely.
- Increasing cigarette taxes to Rs 3691 per 1000 sticks would further add Rs 146.3 billion to tax revenues and prevent 3.4 million premature deaths.



Table 1. Central excise tax on cigarettes, Union Budget 2014-15

Type of cigarette/ Length in mm	Old tax rates (Rs. per 1,000 sticks)	New tax rates in 2014- 15 budget; Effective from 11 July 2014 (Rs. per 1,000 sticks)
Non filter; < 65	669	1,150
Non-filter; 65-70	2,027	2,250
Filter; <65	669	1,150
Filter; 65-70	1,409	1,650
Filter; 70-75	2,027	2,250
Filter; 75-85	2,725	3,290
Other	3,290	

Source: Budget documents, Government of India

Note: In India, taxes on cigarettes/ bidis are levied as tax per 1,000 sticks, not on the value of the product. The price per 1,000 sticks varies within a tier, but tax amount remains the same.

ANNUAL REPORT FROM MINISTRY OF FINANCE , GOI

- Excise duty on cigarettes was increased by 72% for cigarettes of length not exceeding 65 mm and by 11% to 21% for cigarettes of other lengths. Similar increases have been made on cigars, cheroots and cigarillos.
- Basic excise duty was increased from 12% to 16% on pan masala, from 50% to 55% on unmanufactured tobacco and from 60% to 70% on jarda scented tobacco, gutkha and chewing tobacco.



ARGUMENTS ON SIN TAX

- The price of vice.
- Crime or No crime ?
- Increase revenue of Govt.
- Making Poor people poorer.
- Healthier and more prosperous people.



Thank You

