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MARSLAND PRESS
Multidisciplinary Academic Journal Publisher

Study on Interlink among NEP, Fiscal Policy, Social Variables, Remittance and Poverty

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Abstract: Developing countries are not capable to design progressive tax structure. The government expenditure on social sector is low. Under WTO regime, developing countries are forced to withdraw subsidies. There is a big gap between the income level of high-profile skilled workers and labour class who are not so highly skilled. Growth rate is higher in urban areas compared to rural areas leading to increasing regional disparities. The employment and wage rate has decreased in rural areas.

[Sharma, D. and Bhupender. **Study on Interlink among NEP, Fiscal Policy, Social Variables, Remittance and Poverty.** *Academ Arena* 2022;14(8):1-5]. ISSN 1553-992X (print); ISSN 2158-771X (online) http://www.sciencepub.net/academia. 01. doi:10.7537/marsaaj140822.01.

Key words: Interlink among NEP, Fiscal Policy, Social Variables, Remittance and Poverty

INTRODUCTION:

In the context of the stabilization role of fiscal policy, we are concerned with the effects of changes in fiscal variables on aggregate demand and income, employment and prices. Fiscal policy plays an important role to economic growth and stabilization policy, although political pressures, external shocks and administrative shortcomings have frequently weakened government control over this instrument. The policy instruments aims at to get as close as possible to the natural level of output and zero inflation as assumed by first-best outcome. Due to the imperfections existed in the market; the first best solution is not achievable. Therefore, fiscal instruments could be used to get closer to the first-best solution i.e. second-best. Work effort, exports, productive investment,savings, and capital flight, foreign investment and so on is affected by the choice of specific fiscal instrument. It affects aggregate demand, the distribution of wealth, and the economy's capacity to produce goods and services. Ultimately growth and stability is inevitably influenced by the fiscal policy measures utilized.

Fiscal policy can be a major stabilizing force contributing to move from disequilibrium to equilibrium in the external sector in recent years. The fiscal deficits and external debt problem has become a foremost fiscal problem in most of the developing countries. Discretionary fiscal policy i.e. changes in taxes and transfers are most effective fiscal instruments for stabilization. These instruments are likely to change the consumption spending in response to temporary changes in disposable income. NEP has great implications for tax systems and for expenditure policies.

Capital formation is an important limiting factor for growth In the underdeveloped countries. Incomes of people are so low that hardly anything is left after meeting the subsistence level of consumption. There is considerable inequality in the distribution of wealth and income. There is huge amount of tax evasion. Those who have capacity to pay the income tax are motivated by hiding their income for tax purposes. Upper income groups invest their saving in less productive sector. They invest major part of their savings in consumption for social prestige like jewellery (Kumar, 1999).

Does globalization enhances the role of fiscal policy in economic stabilization? Many believe that globalization has positive impact on the economy because the average tax rate has come down in the world's most open economies as nations compete for productive resources. Rodrik (1997) found that there is a strong relation between the openness in trade and the size of government which implies that the disbursement of government contributes largely in reducing the risk rate in open economy of every country. Globalization on fiscal policy had great impacts in terms of trade and capital inflows which has micro-economic significance.

Critics argue that globalization is always in favour of urban population. Investment takes place in urban areas with more profit motive. The fiscal policy under NEP is formulatedto support the well-off section of the society.

Revenue and Expenditure:

Under NEP, a particular concern has been for all countries to lower corporate tax rates and the evidences show a sizeable reduction in corporate tax rates worldwide. The evidence for emerging markets in Asia and Latin America also suggests a recent decline in corporate tax rates. However, in many developing countries including India, the share of corporate tax in total tax revenue is low and does not make remarkable difference in tax collection by reducing corporate tax rate. But it is well known that reduction in corporate tax rate has negative impact on poverty reduction because it increases income inequality in the country. The proponents of NEP argue that despite the reduction in effective tax rates, corporate tax revenue has held up well. Industrial countries have experienced an increase in corporate tax revenue on average, both relative to GDP and to total tax revenue. A similar trend is observed in emerging market countries, where corporate tax revenue now accounts for almost 20 percent of total tax revenue, which is the highest ratio recorded for these countries. Clearly corporate tax revenue was boosted by the earlier strengthened pace of economic activity and record-high profits in many countries. Critics argue that the share of corporate tax in many countries has increased due to increase in profit margin after introduction of NEP.

Another issue is the VAT implementation in developing countries. The revenue impact of VAT is been more controversial and unclear. It is argued that VAT is difficult to implement in developing countries like India where business community do not keep proper account. It is not able to collect desired level of revenue. Tax administration in developing countries is inefficient leading to corruption in tax collection. The basic idea ofNEP was to cut government expenditure. The evidence on the impact of globalization on public expenditure is mixed. Studies have shown that increased trade openness may stimulate higher government spending (Rodrik, 1997). However, many argue that globalization has restrained social sector expenditures in many countries. The process of NEP has decreased the level of subsidy in developing countries. A majority of the developing countries have now become net food importing countries. The drastic reduction in agricultural subsidies has increased food prices worldwide leading to the problem of hunger in developing countries. Low-skilled workers lose their jobs as government expenditure was cut and trade opens up.

The crisis in Indian agriculture is evident from farmers' suicides in every comer of the country and since 1995 more than 25000 farmers have committed suicides all over the country. This is because of the cascading effect of the capital-intensive, corporate agribusiness-driven, export-oriented, peasant-insensitive domestic policies coupled with the subsidized import surge due to withdrawal of quantitative restrictions, which has led to depression in the domestic commodity prices. The burden of the agrarian distress has fallen on the small and marginal farmers. This is a direct result of the WTO’s Agreement on Agriculture that protects subsidies in the developed countries and allows them to dump cheap commodities in developing countries.

NEP, Fiscal Variables and Black Economy:

Black incomes may be defined as factor incomes and property incomes which should be reporter to the direct tax authorities but are not. The size of black economy is usually reported as a percentage of the reported GDP at market prices.

According to Kumar, black incomes are factor incomes and property incomes which are not reported to the direct tax authorities. Undeclared profits constitute a major part of black economy. Black profit is generated by declaring lower revenue and overstating costs. Lower revenue is restored by under invoicing of price and quantity of the commodity sold. Overestimation of cost is made through inflating costs of purchased inputs, wages etc. There are two ways of showing higher wage-fudging the number of employed and inflating the wage paid (Kumar, 2006). Exclusion of black economy from total economy for policy analysis is not adequate. It results policy failure in both the macro and micro levels. It lowers the rate of investment and raises the savings propensity so that the multiplier falls while the level of income and the growth rate of the economy fall below their potential. Ultimately correct estimates of employment generation and number of population below the poverty line cannot be estimated correctly as actual level of consumption differs by ignoring black economy.

The bulk of black income accrues to the rich class. It is highly unevenly distributed in the favour of very rich. A large part of it is spent on luxury consumptions like wedding, parties etc. which distorts production. In today's life, all social and economic spheres of human life have been affected by politics. Political corruption has grown enormously. It has been widespread and common everywhere. All round political corruption-primary (high places corruption) as well as secondary (intermediate and low positions) has grown up. The economic pressure exerted by repressed inflation has increased political corruption in low level government employees. Kumar (1999) argues that state intervention has been one of the major sources of political corruption both from demand and supply side. It is evident that no foolproof way of estimation of black economy is available. However, some indirect methods based on guesstimates are available in this regard. Some methods which have been used to estimate the magnitude black economy are: the input-output method, the survey approach, the monetarist method and the fiscal approach method.

Some studies have been conducted in India to analyze the inter-linkages between black economy and fiscal and macro variables. These studies also show the magnitude of black economy in Indian context. Acharya and Associates (1985) estimated the size of the black economy to be 20 percent of the white economy for 1980/81. According to S. B. Gupta (1992), genesis of the black economy emerged during scarcity conditions of the Second World War. Black market prices, which were higher than controlled prices gave birth to black incomes. He claims all types of tax evasion (income tax evasion, excise duty evasion, sales tax evasion, and custom duties evasion) as well as smuggling, bribery etc. all are as sources of black incomes. He has included generated (productive) as well as unproductive black money as black incomes. He has divided black incomes into two types - unreportable and reportable incomes. Crime, bribe, black market and black wealth incomes are considered under unreportable black incomes. Black incomes which are earned through legitimate economic activities but not reported to the tax authorities i.e. all wages and salaries, corporate dividend, interest and rental incomes received against proper receipt fall under reportable black incomes. According to him, the size of the black economy was 42 percent of GDP in 1980/81 and 51 percent in 1987/88.

According to Kumar, the black economy in India has grown from 4 percent of GDP in 1955/56 to 40 percent in 1995/96. With the advent of NEP in India in 1991, the magnitude of black economy is growing very fast. It has resulted to the shortage of budgetary resources for economic development of the country which has increased social tensions and crime in the society. As a result, employment generation and poverty reduction has been negatively affected (Kumar, 1999). The magnitude of black economy until now is unknown in India because no study is undertaken regarding the issue. Black income is generated as a result of the unreported income to the tax authorities. For example, if the government expenditure accrues to the private sector through siphoning out of public funds, it creates illegal income to the private sector. In the meantime, the total government expenditure is included in the national account statistics though the actual benefit is less than the Amount recorded. Therefore, one can say that the part of the black income generated is captured in the national account statistics. In the case of unorganized sector, some incomes generated are not recorded in the national account of the activities, which rue not traceable. In this case, part of the white economy is missed out from the national account statistics.

Black economy represents the illegality rooted in the economy. However, it is not true that black incomes include all the illegal incomes, arising from illegal economic activities. Only the activities, which are associated with production of goods and services, are taken into account when estimating black and white incomes for the respective economy. Bribes and corruption are merely transfer payments passing from bribe giver to bribe taker. But in the case of under reporting of production by a firm, it is illegal and is associated with the income generating activities. This would definitely under estimate the reported GDP. This deliberate suppression of output undertaken to evade the tax would lead to generate black incomes in the total economy.

Estimates of GDP for any country includes the factor incomes earned during the particular year based on the income approach. The point is that income which is associated with the production of goods and services are taken into account. This estimated GDP does not include the payments in the nature of transfer from one person to person or sector to sector such as capital gain, pension etc. Therefore, when estimating the black income, it should include only corresponding nature of the income which are taken into account while estimating the white income. This is to say that black income also should be estimated in the same way the white data estimated. Then only there will be uniformity, comparability, consistency and analytical clarity between black and white economies. Bribe and corruption are transfer income in nature and these should not be included in the black income though these have implications on other macro-economic variables such as savings, investment etc.

Bardhan (1997) argues that bribes take two forms; one is to get the things done which is part of the bribe taker's duty. The other form is the bribe for a work that is not a part of the duty of the bribe taker. It is argued that since the latter is well related to income generating activities, it should be consider as black income. But the point here is that the payment for bribes are made out of the illegal incomes and if the bribe is counted as black incomes, this would lead to double counting in the black economy. Therefore, transfer payments such as bribes, corruption, capital gains from selling fixed assets or shares of the stock markets should not be a part of the black economy.

Income generating activities should only be included in black economy. For instance, if we take the under-reporting of output of production, it is related with the income generating activities and under-estimate the reported GDP by the amount it is concealed. It is the illegal income generated in the normal course of production activities and it becomes the part of the black income. Black incomes are property incomes, factor income such as profit, rent, interest and dividend, not declared to the tax authorities. It should be noted here that rent, dividend and interest are the by-product of gross profits. Gross profits consist of white profit as well as black profits. Black profits are generated in the economy in several ways. For instance, in an industry, the profit is calculated by deducting cost from the revenue during the particular accounting period and reported in the financial statement of the firm.

The reported income in the financial statement could have been manipulated by reporting less revenue (than actual) and more total cost (than actual). In this exercise, on the expenditure side, the usual manipulation undertaken to over-state the expenditures are; personal expenses shown as business expenses, purchases are over-invoiced, fictitious names are included in the payroll which results in over-stating the salaries and wages. On the revenue side, gross revenue is understated through under invoicing sales. This could be done by under-stating sales prices and hiding quantities of production or both. Further, some productions are not shown in the books and some are declared as damaged or waste. Further, stocks of raw materials and finished goods are under-valued to show less gross profit for the firm, though the real values are much higher than the declared values. In this way, illegal incomes are generated in the firms through legal activities. By doing so, off-balance sheet profit, the black profits, could be generated and kept outside the business. In addition to these, illegal activities are also generating black profits, which are not included in the national accounts. These are smugglings, drug trafficking, gambling, prostitution etc. In this case, parts of the black profits are accruing outside the country especially from smuggling and drug trafficking. The above analysis requires a clear description for black economy.

Impact of Fiscal Policy on Poverty:

Poverty is a multidimensional phenomenon. The problem ranges from low income to social and political marginalization in the society which includes deprivation in terms of food, clothing, shelter, basic social services like primary education, primary health care, sanitation etc. Failure of fiscal policy is one of the most important causes of widespread poverty in developing countries. The measuring tools of poverty incidence (HCR, HDI and PPP concepts) do not reflect the full range in developing countries because of various methodological problems which has been based on western standards. Moreover, the estimated poverty incidence is affected by many variables as well. Many of these variables are not included while estimating poverty and the poverty estimates become incorrect.

Purchasing Power Parity (PPP) and Poverty Measurement:

Purchasing Power Parity (PPP) concept of poverty line used by the International Comparison Program (ICP) of the World Bank is applied because nominal exchange rates do not always reflect international differences in relative prices. It is a way to measure the value of currency that allows economists and poverty researchers to compare the standards of living in different countries while accounting for differences in both wages and costs of living. In general, PPP refers to the goods and services that a currency has the power to buy, expressed as a basket of necessary items. PPP measures how much the same basket of goods and services costs around the world allowing for a standard comparison of real price levels between countries. The PPP number in each country should allow people to purchase the same basket of goods and services that a U.S. dollar can purchase in the United States.

Generally speaking, earning a dollar per day or less means that a person in any country is basic human necessities. However, one dollar a day is not a literal amount of money. Rather, it means a dollar a day at purchasing power parity in 1985 prices. Because the dollar-a-day standard was conceived in 1990, currency values of 1985 were used as a baseline. By 1993 the value of the U.S. dollar had changed, so that one dollar a day was actually equal to $1.08 per day. Nevertheless, the term dollar a day is still used because it is simpler and easier to remember. Most researchers agree that purchasing power parity is, to date, the best way to examine poverty at the global level. Critics of PPP point out that one problem with the measure lies in the notion of what is and is not a necessity: a product or service considered a staple in one culture may be a luxury in others. Second, the two sets of PPPs (1985 and 1993) are not comparable. So there is no straightforward way to convert the old day line at 1985 PPP to a new line with base 1993. Third, the ICP-PPPs are based on prices of commodities that are not representative of the consumption baskets of the poor and thus the resulting poverty numbers change substantially when food-based PPPs rather than general consumption PPPs are used as an indicator or proxy for the costs faced by the poor in relation to their basic needs. Moreover, the ICP-PPPs make use of weights for purposes of aggregating price data that do not adequately represent the consumption patterns of the poor. Some believe that poverty level declines in developing countries when PPP concept is used. However, critics argue that when PPP concept is used to measure poverty line, upper class people get benefit but the actual poor losses as the value of their services is low in LDCs.

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7/25/2022