

The wrong options

It has been well over three years since the government led by Prime Minister Narendra Modi assumed power at the Centre. Mr. Modi's election promise of creating a "minimum government" that would liberalise the economy by cutting down the size of the government's influence over the economy remains a pipe-dream. Instead, each passing day, the goods and services tax (GST) and demonetisation are being touted as big-bang reforms that, despite the short-term costs, will bring long-term economic benefits to the nation. To be sure, many, but not all, of the negative effects of demonetisation and the implementation of GST are likely to be transitory. But, contrary to the claims of many pundits, neither of these reforms will boost the country's economic growth rate over the long run.

For one, demonetisation was nothing more than a temporary demand shock that brought the wheels of commerce to a halt. It is another matter that it failed to achieve its primary objective of mass confiscation of illegal wealth. GST, on the other hand, is a fiscal programme to increase the government's ability to tax more citizens in the large informal economy, which also manages to kill the scope of tax competition between States. These are very different from actual positive tax reforms that aim to reduce the burden of taxes on citizens in order to boost economic growth. In essence, both GST and demonetisation are measures to increase, rather than reduce, the role of the government in the economy. Given this, the economic slowdown caused by these reforms will simply go down in history as having caused unnecessary pain to citizens without any gain to speak of.

Support for so-called reforms like GST and demonetisation comes from the underlying belief that a government awash in tax revenues will be able to boost economic growth. Sadly, the fact remains that no country has ever taxed its way to prosperity. In fact, it is not the lack of sufficient tax revenues that has held back India, or any other country for that matter that has suffered the ill-effects of socialism, over the years. Instead, it is simply the lack of economic freedom which impedes ordinary individuals from seeking to improve their economic status without any interference from the state.

What India needs, in other words, is not increased tax compliance among citizens, but pro-market reforms that will make the country a free and competitive marketplace. A government that allows free competition, without favouring special interest groups, either through pro-business or pro-poor policies, will also be sowing the seeds for improved living standards. As several scholars have pointed out, historically this is pretty much the only way countries have managed to free themselves from the shackles of poverty. In this regard, Mr. Modi, obviously, has done very little that is different from his predecessors; real structural reforms with long-term benefits have simply been ignored. It might be the reason why he has been forced to celebrate non-reforms as revolutionary programmes that will transform the economy.

The new U.S. Fed Chairman is unlikely to opt for policies that might upset the President's plan

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