

# SEMESTER -IV

## Fiscal Policy of India

### INTRODUCTION

The economic policy is bothered with the raising of government revenue and incurring of government expenditure. To generate revenue and to incur expenditure, the government frames a policy known as budgetary policy or fiscal policy. So, the fiscal policy is concerned with government expenditure and government income. Fiscal policy must pick 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 economic policy refers to "that section of national economic policy that is primarily involved with the receipts and expenditure of central government." In alternative words, economic policy refers to the policy of the government with respect to taxation, public expenditure and public borrowings. The importance of economic policy is high in underdeveloped countries. The state must play active and necessary role. In a very democratic society direct strategies don't seem to be approved. So, the government must rely upon indirect methods of laws. during this method, fiscal policy could be a powerful weapon within the hands of state by means of which it can do the objectives of development. In economics and political science, fiscal policy is the use of government revenue collection (mainly taxes) and expenditure (spending) to influence the economy

Fiscal policy also feeds into economic trends and influences monetary policy. **When the government receives more than it spends, it has a surplus.** If the government spends more than it receives it runs a deficit. To meet the additional expenditures, it needs to borrow from domestic or foreign sources, draw upon its foreign exchange reserves or print an equivalent amount of money. This tends to influence other economic variables.

On a broad generalization, **excessive printing of money leads to inflation.** If the government borrows too much from abroad it leads to a debt crisis. Excessive domestic borrowing by the government may lead to higher real interest rates and the domestic private sector being unable to access funds resulting in the "crowding out" of private investment. So it can be said that the fiscal deficit can be like a double edge sword, which need to be tackled very carefully.

### Main Objectives of Fiscal Policy in India

Fiscal policy of India always has two objectives, namely improving the growth performance of the economy and ensuring social justice to the people.

**1. Development by effective Mobilisation of Resources:** The principal objective of fiscal policy is to ensure rapid economic growth and development. This objective of economic growth and development can be achieved by Mobilisation of Financial Resources. The central and state governments in India have used fiscal policy to mobilise resources.

**The financial resources can be mobilised by:-**

a. **Taxation:** Through effective fiscal policies, the government aims to mobilise resources by way of direct taxes as well as indirect taxes because most important source of resource mobilisation in India is taxation.

b. **Public Savings:** The resources can be mobilised through public savings by reducing government expenditure and increasing surpluses of public sector enterprises.

c. **Private Savings:** Through effective fiscal measures such as tax benefits, the government can raise resources from private sector and households. Resources can be mobilised through government borrowings by ways of treasury bills, issuance of government bonds, etc., loans from domestic and foreign parties and by deficit financing.

**2. Reduction in inequalities of Income and Wealth:** Fiscal policy aims at achieving equity or social justice by reducing income inequalities among different sections of the society. The direct taxes such as income tax are charged more on the rich people as compared to lower income groups. Indirect taxes are also more in the case of semi-luxury and luxury items which are mostly consumed by the upper middle class and the upper class. The government invests a significant proportion of its tax revenue in the implementation of Poverty Alleviation Programmes to improve the conditions of poor people in society.

**3. Price Stability and Control of Inflation:** One of the main objectives of fiscal policy is to control inflation and stabilize price. Therefore, the government always aims to control the inflation by reducing fiscal deficits, introducing tax savings schemes, productive use of financial resources, etc.

**4. Employment Generation:** The government is making every possible effort to increase employment in the country through effective fiscal measures. Investment in infrastructure has resulted in direct and indirect employment. Lower taxes and duties on Small scale industries units encourage more investment and consequently generate more employment. Various rural employment programmes have been undertaken by the Government of India to solve problems in rural areas. Similarly, self employment scheme is taken to provide employment to technically qualified persons in the urban areas.

**5. Balanced Regional Development:** there are various projects like building up dams on rivers, electricity, schools, roads, industrial projects etc run by the government to mitigate the regional imbalances in the country. This is done with the help of public expenditure.

**6. Reducing the Deficit in the Balance of Payment:** some time government gives export incentives to the exporters to boost up the export from the country. In the same way import curbing measures are also adopted to check import. Hence the combine impact of these measures is improvement in the balance of payment of the country.

**7. Increases National Income:** it's the strength of the fiscal policy that is brings out the desired results in the economy. When the government want to increase the income of the country then it increases the direct and indirect taxes rates in the country. There are some other measures like: reduction in tax rate so that more peoples get motivated to deposit actual tax.

**8. Development of Infrastructure:** when the government of the concerned country spends money on the projects like railways, schools, dams, electricity, roads etc to increase the welfare of the citizens, it improves the infrastructure of the country. A improved infrastructure is the key to further speed up the economic growth of the country.

**9. Foreign Exchange Earnings:** when the central government of the country gives incentives like, exemption in custom duty, concession in excise duty while producing things in the domestic markets, it motivates the foreign investors to increase the investment in the domestic country.

<https://www.jagranjosh.com/general-knowledge/fiscal-policy-of-india-meaning-objectives-and-impacts-on-the-economy-1448705973-1>

## Techniques of Fiscal Policy of India

The four important techniques of fiscal policy of India, i.e., (1) Taxation Policy, (2) Public Expenditure Policy, (3) Public Debt Policy, and (4) Deficit Financing Policy.

### ***1. Policy of Taxation of Government of India:***

One of the important sources of revenue of the Government of India is the tax revenue. Both the direct and indirect taxes are being levied by the Government of India. Direct taxes are progressive by nature and most of indirect taxes are regressive in nature. Taxation plays an important role in mobilizing resources for plan.

During the First, Second and Third Plan, additional taxation alone contributed nearly 12.7 per cent, 22.8 per cent and 34 per cent of public sector plan expenditure respectively. The same shares during the Fourth, Fifth, Sixth and Seventh Plan were 27 per cent, 37 per cent, 22 per cent and 15 per cent respectively.

**The main objective of taxation policy in India includes:**

- (i) Mobilisation of resources for financing economic development;
- (ii) Formation of capital by promoting saving and investment through time deposits, investment in government bonds, in units, insurance etc.
- (iii) Attainment of equality in the distribution of income and wealth through the imposition of progressive direct taxes; and
- (iv) Attainment of price stability by adopting anti-inflationary taxation policy.

### ***2. Public Expenditure Policy of Government of India:***

Public expenditure is playing an important role in the economic development of a country like India. With the increase in responsibilities of the government and with the increasing participation of government in economic activities of the country, the volume of public expenditure in a highly populated country like India is increasing at a galloping rate.

In 1992-93, the public expenditure as percentage of GDP was around 30 per cent. Public expenditure is of two different types, i.e., developmental and non-developmental expenditure. Developmental expenditure of the government is mostly related to the developmental activities viz., development of infrastructure, industry, health facilities, educational institutions etc.

**The following are some of the important features of the policy of public expenditure formulated by the Government of India:**

**(i) Development of infrastructure:**

Development of infrastructural facilities which include development of power projects, railways, road, transportation system, bridges, dams, irrigation projects, hospitals, educational institutions etc. involves huge expenditure by the government as private investors are very much reluctant to invest in these areas considering the low rate of profitability and high risk involved in it.

**(ii) Development of public enterprises:**

Developments of heavy and basic industries are very important for the development of underdeveloped country. But the establishment of these industries involves huge investment and a considerable proportion of risk. Naturally private sector cannot take the responsibility to develop these industries.

Development of these industries has become a responsibility of the Government of India particularly since the introduction of Industrial Policy, 1956. A significant portion of public expenditure has been utilized for the establishment and improvement of these public enterprises.

**(iii) Support to Private Sector:**

Providing necessary support to the private sector for the establishment of industry and other projects is another important objective of public expenditure policy formulated by the Government of India.

**(iv) Social Welfare and Employment Programmes:**

Another important feature of public expenditure policy pursued by the Government of India is its growing involvement in attaining various social welfare programmes and also on employment generation programmes.

**3. Public Debt Policy of the Government of India:**

As the taxation has got its limit in a poor country like India due to poor taxable capacity of the people, thus the government is taking recourse to public debt for financing its developmental expenditure. In the post-independence period, the Central Government has been raising a good amount of public debt regularly in order to mobilize a huge amount of resources for meeting its developmental expenditure. Total public debt of the Central Government includes internal debt and external debt.

**Internal Debt:**

Internal debt indicates the amount of loan raised, by the government from within the country. The Government raises internal public debt from the open market by issuing bonds and cash certificates and 15 years annuity certificates. The government also borrows for a temporary period from RBI (Treasury bills issued by RBI) and also from commercial banks.

**External Debt:**

As the internal debt is insufficient thus the government is also collecting loan from external sources, i.e., from abroad, in the form of foreign capital, technical know-how and capital goods. Accordingly, the Central Government is also borrowing from international financing agencies for financing various developmental projects. These agencies include World Bank, IMF, IDA, IFC etc. Moreover, the government is also collecting inter-governmental loans from various developed countries of the world for financing its various infrastructural projects.

The volume of public debt in India has been increasing at a considerable rate i.e. from Rs. 204 crore during the First Plan to Rs. 2,135 crore during the Fourth Plan and then to Rs. 1,03,226 crore during the Seventh Plan. During the Eighth Plan, the volume of internal debt of the Central Government was amounted to Rs. 1,59,972 crore and that of external debt was to the extent of Rs. 2,454 crore. At the end of the second year of the Ninth Plan, i.e., in 1998-99 (BE), total outstanding loan (liabilities) of the Central Government stood at Rs. 8,68,206 crore.

#### 4. Policy of Deficit Financing of Government of India:

Following the policy of deficit financing as introduced by J.M. Keynes, the Government of India has been adopting the policy for financing its developmental plans since its inception. The deficit financing in India indicates taking loan by the government from the Reserve Bank of India in the form of issuing fresh dose of currency.

Considering the low level of income, low rate of savings and capital formation, the government is taking recourse to deficit financing in increasing proportion. Deficit financing is a kind of forced savings. Accordingly, Dr. V.K.R.V. Rao observed, "Deficit financing is the name of volume of those forced savings which are the result of increase in prices during the period of the government investment. Thus deficit financing helps the country by providing necessary funds for meeting the requirements of economic growth but at the same time it also create the problem of inflationary rise in prices. Thus the deficit financing must be kept within the manageable limit."

During the First, Second, Third and Fourth Plan deficit financing as percentage of total plan resources was to the extent of 17 per cent, 20 per cent, 13 per cent and 13.5 per cent respectively. But due to adverse consequence of deficit financing through inflationary rise in price level, the extent of deficit financing was reduced to only 3 per cent during the Fifth Plan. But due to resource constraint, the extent of deficit financing again rose to 14 per cent and 16 per cent of total plan resources respectively.

Thus knowing fully the evils of deficit financing, planners are still maintaining a high rate of deficit financing in the absence of increased tax revenue due to large scale tax evasion and negative contribution of public enterprises. But considering the present inflationary trend in prices, the government should give lesser stress on deficit financing.

[https://www.yourarticlelibrary.com/india-2/fiscal-policy/top-4-techniques-of-fiscal-policy-of-india/63279#:~:text=Here%20we%20detail%20about%20the,\(4\)%20Deficit%20Financing%20Policy.](https://www.yourarticlelibrary.com/india-2/fiscal-policy/top-4-techniques-of-fiscal-policy-of-india/63279#:~:text=Here%20we%20detail%20about%20the,(4)%20Deficit%20Financing%20Policy.)

## **Advantages of Fiscal Policy**

### **1. Provides investment opportunities**

Businesses and investors identify an opportunity when there is an expansionary policy since the government allows more money to flow into the economy. They also benefit from this since the government has lowered taxes, so it's easier to explore new opportunities where they can expect to grow and thrive.

### **2. Changes in taxation**

The government will change the taxation rates from time to time to mitigate inflation. Businesses thrive more when the taxes have been lowered, and a huge money supply is available.

### **3. A rise in living standards and employment**

As more money flows into an economy and taxes reduce, businesses get the opportunity to hire more people. Therefore, this will lead to a low unemployment rate, which may arise, and a rise in living standards while reducing poverty levels.

## **Disadvantages of Fiscal Policy**

### **1. Slows economic activities**

When the contractionary policy is implemented, it slows down inflation, taxes are raised, and the growth of businesses is slowed down. Contractionary fiscal policy may also lead to the total death of new businesses which cannot keep up with the current economic events.

### **2. Increase in unemployment rates**

During a contractionary policy, when taxes are raised and the money supply is reduced, industries and businesses react by laying off some employees. This is done to mitigate and reduce the cost of production in that period and maximize profits. This will increase the rate of unemployment and poverty in a nation.

## **How Do Individual Businesses React to Different Changes in Fiscal Policy?**

Unlike larger businesses, smaller businesses are often more affected by fiscal policies because they lack adequate resources to adjust. Individual small businesses should aim to form groups that will allow them to utilize resources offered by the government fully.

As the popular saying goes, 'no man is an island' together, many small businesses will profit from the increased money supply from the government. Furthermore, in case of a crisis, when tax rates are increased and the money supply has been reduced due to reduced government spending, these businesses will be able to look out for each other and prevent death for some of their own.

## **Fiscal Reforms in India**

India has undergone significant fiscal reforms since its independence in 1947. These reforms have been aimed at modernizing the economy, reducing fiscal imbalances, improving the efficiency of public spending, and promoting economic growth. Here are some of the major fiscal reforms that India has implemented since independence:

1. **Taxation Reforms:** Taxation has been a critical area of focus for fiscal reforms in India since independence. In the early years, the government introduced several new taxes and increased tax rates to expand its tax base. However, these efforts were largely ineffective due to a lack of infrastructure and administrative capacity.

In the 1990s, the Indian government introduced significant tax reforms to modernize the tax system and improve its efficiency. The most significant of these was the introduction of the Value Added Tax (VAT) in 2005, which replaced the complex system of sales taxes that had previously been in place. The introduction of GST (Goods and Services Tax) in 2017 unified various indirect taxes, making it one of the biggest tax reforms in the history of independent India.

In addition to these reforms, the government has also introduced measures to simplify tax procedures, reduce compliance costs, and encourage tax compliance. For example, the government has introduced electronic filing of tax returns, simplified tax forms, and increased the use of technology in tax administration.

2. **Fiscal Deficit Management:** Fiscal deficit management has been another critical area of focus for fiscal reforms in India. In the early years of independence, the government focused on expanding its public sector and infrastructure, leading to large fiscal deficits. This trend continued until the 1990s when India faced a balance of payments crisis that forced the government to undertake structural reforms.

As part of these reforms, the government introduced the Fiscal Responsibility and Budget Management (FRBM) Act in 2003 to reduce the fiscal deficit. The act set targets for reducing the fiscal deficit to 3% of GDP by 2008-09. The government also introduced the Medium-Term Fiscal Policy Statement and the Fiscal Policy Strategy Statement, which provided a roadmap for fiscal consolidation.

The government has also introduced measures to improve the quality of public expenditure and enhance fiscal discipline. For example, the government has introduced program budgeting, which links the budget to the results achieved, and zero-based budgeting, which requires every budget item to be justified every year.

3. **Subsidies and Welfare Programs:** Subsidies and welfare programs have been a major area of focus for fiscal reforms in India. The government has traditionally provided subsidies for essential goods like food, fuel, and fertilizers. However, these subsidies have been criticized for being inefficient, as they benefit only a small section of the population and are prone to leakages.

In recent years, the government has introduced several reforms to improve the efficiency of its subsidy programs. One of the most significant of these was the Direct Benefit Transfer (DBT) scheme, which was introduced in 2013. Under this scheme, subsidies are directly transferred to beneficiaries' bank accounts, eliminating intermediaries and reducing the scope for leakages.

The government has also introduced measures to target subsidies to the most vulnerable sections of the population. For example, the government has introduced the National Food Security Act, which provides subsidized food grains to over 800 million people, and the Pradhan Mantri Ujjwala Yojana, which provides free cooking gas connections to poor households.

4. **Public Sector Reforms:** India's public sector has traditionally been a significant area of focus for fiscal reforms. In the early years of independence, the government expanded the public sector to promote industrialization and economic growth. However, the public sector became bloated and inefficient, leading to fiscal imbalances and inefficiencies.

To address these issues, the government has implemented several public sector reforms over the years. These include privatization, disinvestment, and improving the efficiency of public sector enterprises.

The government launched its privatization program in the 1990s, with the aim of reducing the size and scope of the public sector. Under this program, the government has sold or leased several public sector enterprises to private companies. These include companies in sectors like telecommunications, aviation, and power generation.

In addition to privatization, the government has also introduced disinvestment of public sector enterprises. Under this program, the government sells a portion of its equity in public sector enterprises to the public, institutional investors, or other companies. The aim of disinvestment is to raise resources for the government, while also improving the efficiency of public sector enterprises.

The government has also introduced measures to improve the efficiency of public sector enterprises. For example, the government has introduced performance-related pay, which links the pay of public sector employees to their performance. This has led to improved productivity and efficiency in public sector enterprises.

5. **Financial Sector Reforms:** The financial sector has been a critical area of focus for fiscal reforms in India since independence. In the early years, the government nationalized several banks and introduced several regulations to promote financial inclusion and stability.

However, the financial sector faced several challenges in the 1990s, including high levels of non-performing assets, poor asset quality, and low levels of capitalization. To address these challenges, the government introduced significant financial sector reforms in the 1990s.

These reforms included liberalizing interest rates, allowing foreign investment in the banking sector, and introducing prudential norms for banks. The government also set up regulatory bodies like the Securities and Exchange Board of India (SEBI) and the Insurance Regulatory and Development Authority (IRDA) to regulate the financial sector.

In recent years, the government has introduced several measures to promote financial inclusion and improve access to credit. These include the Pradhan Mantri Jan Dhan Yojana, which provides basic banking services to the unbanked population, and the Micro Units Development and Refinance Agency (MUDRA) scheme, which provides credit to small and micro-enterprises.

6. **Public Finance Management Reforms:** Finally, India has introduced several public finance management reforms over the years. These reforms have aimed to improve the efficiency of public spending, reduce fiscal imbalances, and promote transparency and accountability in the use of public funds.

Some of the key public finance management reforms in India include the introduction of outcome-based budgeting, the establishment of fiscal responsibility and budget management (FRBM) rules, and the adoption of the accrual accounting system. These reforms have led to improved efficiency and accountability in public spending. However, there is still scope for further reforms to improve public finance management in India.

7. **Green Fiscal Reforms:** Green fiscal reforms refer to the use of fiscal policies to promote environmental sustainability and address climate change. India has introduced several green fiscal reforms over the years, including the introduction of taxes on carbon emissions and the promotion of renewable energy.

In recent years, the government has introduced several measures to promote the use of clean energy, including the National Solar Mission and the National Wind Mission. The government has also introduced tax incentives for businesses that invest in renewable energy.

These green fiscal reforms have helped to promote environmental sustainability and reduce India's dependence on fossil fuels. They have also helped to create new opportunities for businesses in the renewable energy sector.

### **Outcomes of reforms**

The outcomes of fiscal reforms in India have been significant and have had a major impact on the country's economy and society. Some of the key outcomes of fiscal reforms in India include:

1. **Improved Fiscal Discipline:** One of the key outcomes of fiscal reforms in India has been improved fiscal discipline. Through measures such as the Fiscal Responsibility and Budget Management (FRBM) Act, the government has been able to reduce fiscal deficits and stabilize public debt. This has helped to improve the credibility of India's fiscal policy and reduce the risk of fiscal crises.

2. **Increased Tax Revenue:** Another major outcome of fiscal reforms in India has been the increase in tax revenue. Reforms such as the introduction of the Goods and Services Tax (GST) and the Direct Benefit Transfer (DBT) scheme have helped to improve tax compliance and reduce tax evasion. This has led to an increase in tax revenue, which has helped to support public expenditure on social welfare programs and infrastructure development.
3. **Greater Efficiency in Public Spending:** Fiscal reforms have also helped to improve the efficiency of public spending in India. Through measures such as the introduction of the Public Financial Management System (PFMS), the government has been able to improve the transparency and accountability of public spending. This has helped to reduce wasteful expenditure and improve the quality of public services.
4. **Promotion of Inclusive Growth:** Fiscal reforms in India have also helped to promote inclusive growth by supporting the development of key sectors such as agriculture, infrastructure, and social welfare. For example, reforms such as the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) have helped to provide employment opportunities and support for rural communities. The government's focus on improving access to education and healthcare has also helped to promote inclusive growth.
5. **Environmentally Sustainable Growth:** Finally, fiscal reforms in India have also helped to promote environmentally sustainable growth. Through measures such as the National Solar Mission and taxes on carbon emissions, the government has been able to promote the use of clean energy and reduce India's dependence on fossil fuels. This has helped to address the challenges of climate change and promote sustainable development.

Overall, the outcomes of fiscal reforms in India have been significant, with improvements in fiscal discipline, tax revenue, public spending efficiency, promotion of inclusive growth, and environmentally sustainable growth. While challenges remain, continued efforts to implement effective fiscal reforms will be critical to India's future success.

### **Challenges in Fiscal Reforms**

Despite the significant progress made in implementing fiscal reforms in India, there are still several challenges that need to be addressed. Some of the key challenges in fiscal reforms in India include:

1. **Political Resistance:** Political resistance remains a significant challenge to the implementation of fiscal reforms in India. The country's democratic structure often leads to political polarization and disagreement among different interest groups, making it difficult to build political consensus for necessary fiscal reforms. As a result, many reforms are delayed or watered down, which can undermine their effectiveness.
2. **Weak Administrative Capacity:** Another major challenge is the weak administrative capacity of the government at various levels. The lack of adequate resources, technical expertise, and training can hinder the effective implementation of fiscal reforms, which require complex policy design and precise execution. Weak administrative capacity can also undermine the credibility of fiscal institutions, such as tax authorities and public financial management systems, which can reduce the effectiveness of fiscal reforms.
3. **Resistance from Interest Groups:** Powerful interest groups such as farmers, labor unions, and business associations can also pose significant challenges to fiscal reforms in India.

These groups may resist reforms that could negatively impact their interests, such as reductions in subsidies or tax incentives. This can create pressure on policymakers to delay or abandon reforms, which can undermine the credibility of the government and reduce the effectiveness of fiscal reforms.

4. Fiscal Federalism: India's federal structure, which gives significant autonomy to states, can pose challenges to the implementation of fiscal reforms. Coordination between the central and state governments is often difficult, which can lead to conflicts over the allocation of resources, the design of tax policies, and the sharing of responsibilities. This can hinder the effective implementation of fiscal reforms, which require a coherent national strategy and consistent policy design.
5. Informal Economy: India's large informal economy also poses challenges to the implementation of fiscal reforms. Many businesses and individuals operate outside the formal tax system, which reduces the government's tax revenue and makes it difficult to enforce tax compliance. This can undermine the effectiveness of fiscal reforms, such as the GST, which rely on a broad base of taxpayers to generate revenue.

In conclusion, while fiscal reforms in India have achieved significant progress in recent years, several challenges still need to be addressed. Political resistance, weak administrative capacity, resistance from interest groups, fiscal federalism, and the large informal economy pose significant challenges to the implementation of fiscal reforms in India. Addressing these challenges will require a sustained effort to build consensus, strengthen institutions, and improve policy design and implementation.

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## Fiscal Deficit in India – Trends and Analysis

### Introduction

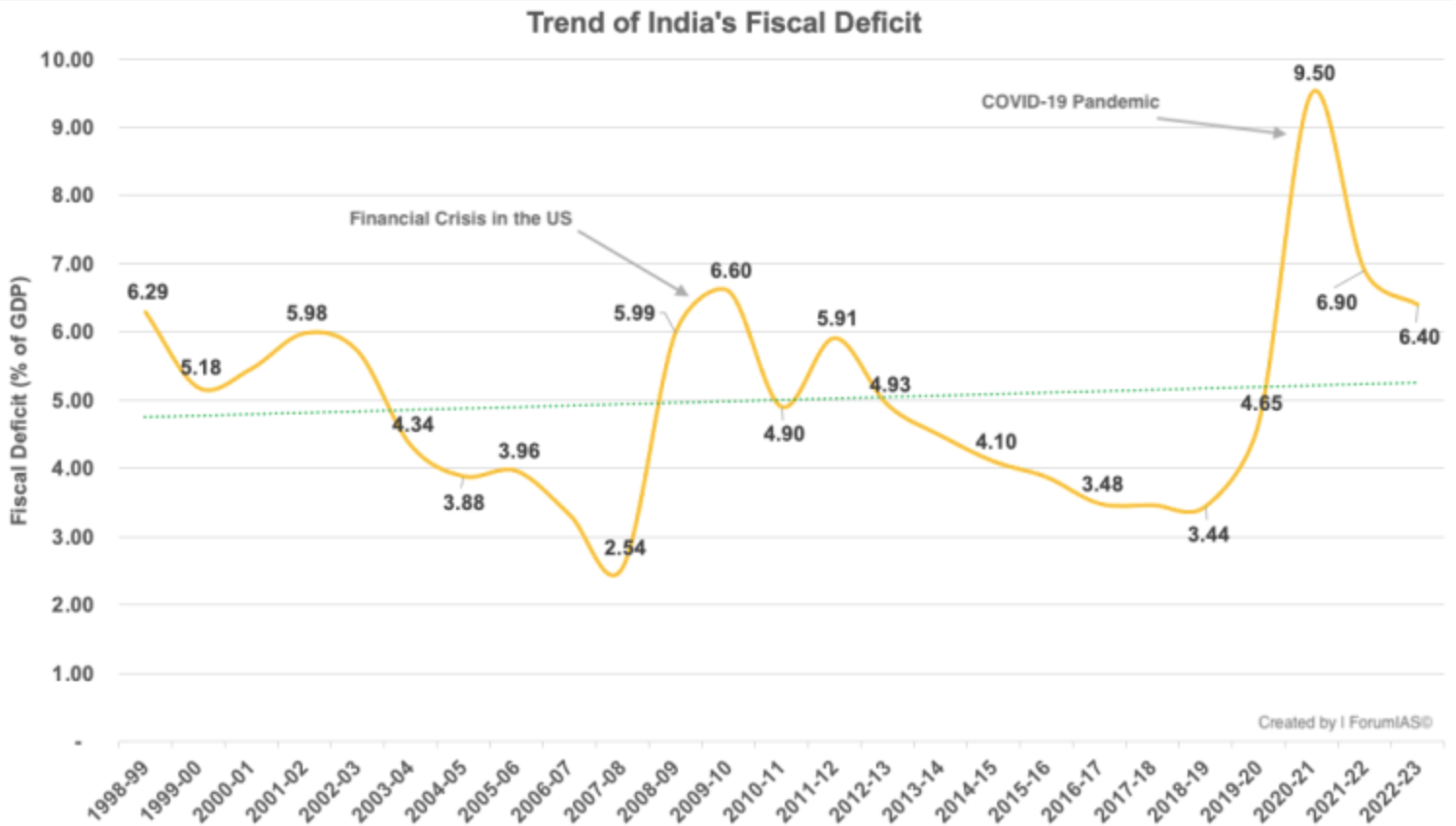
The Union Government had estimated the Fiscal Deficit to be INR 16.61 lakh crore for FY2022-23. As of November 2022, the Government's Fiscal Deficit stood at INR 9.58 lakh crore, which is ~58% of the full-year estimate. The Budget estimate of Fiscal Deficit (INR 16.61 lakh crore) is ~6.4% of India's GDP. The Fiscal Responsibility and Budget Management (FRBM Act, 2003) prescribes the limit of Fiscal Deficit to be 3% of the GDP. However, successive Governments, since 2003-04, have failed to achieve this target due to multitude of justifiable and unjustifiable reasons. The Act itself has been amended 4 times to change the target dates. While the breach of limit seems reasonable based on certain grounds (like COVID-19 pandemic or global macroeconomic developments), the debate regarding freebies and their impact on Governments' finances has reignited debate regarding Governments' obligation to adhere to fiscal prudence and the target of 3% Fiscal Deficit prescribed by the FRBM Act.

The Parliament had passed the Fiscal Responsibility and Budget Management Act (FRBM Act) in 2003. The Act's goal is to ensure **intergenerational equity in fiscal management, long-run macroeconomic stability, better coordination of fiscal and monetary policy, and transparency in the Government's fiscal operations**. One of the Key Targets of the FRBM Act is to limit the Fiscal Deficit to 3% of GDP. However, the target date of achieving the target has been pushed forward through successive amendments to the Act.

The Fifteenth Finance Commission has suggested that the Union Government should bring down fiscal deficit to 4% of GDP by 2025-26. For State Governments, it has recommended the fiscal deficit limit (as % of GSDP) of: **(a) 4% in 2021-22; (b) 3.5% in 2022-23; (c) 3% during 2023-26.**

### What has been trend of India's Fiscal Deficit?

For 2022-23, the Government had estimated the Fiscal Deficit to be INR 16.61 lakh crore or 6.4% of the GDP. As of November 2022, the fiscal deficit had touched 58% of the full year budget estimate.



The Fiscal Deficit of the Government had fallen to 2.54% of the GDP in FY2007-08. However, due to the global financial crisis and the consequent fiscal stimulus by the Government to boost growth resulted in fiscal deficit rising to 6.6% of the GDP in FY2009-10 and 5.9% of GDP in FY2011-12.

The deficit had gradually reduced since then, having fallen to 3.44% of the GDP in FY2018-19. However, the COVID-19 pandemic, and the Government's fiscal package to rescue the economy from lockdowns, resulted in Fiscal Deficit of 9.5% in FY2020-21. It was 6.9% in FY2021-22 and 6.4% in FY2022-23 (estimated).

### What are the reasons for high Fiscal Deficit in India?

#### Revenue Side

**Tax-to-GDP Ratio:** In India, it is low at around 10-11% of GDP and it has stayed at close to that level for the last 20 years. In contrast, Sweden has ratio of ~26%, the UK and France 25%, South Africa 23%. This means Government collects less revenue causing higher fiscal deficit. This has also lead to lower rate of investment and lower GDP growth.

**Narrow Tax Base:** An overwhelming majority of Indians do not pay taxes, Indian tax revenues remain largely **dependent on indirect tax collections** which include all taxes on spending (such

as GST). According to Ministry of Finance, only 5.83 crore Income Tax Returns were filed in Assessment Year 2022-23. (~4% of India's population).

## Expenditure Side

**High Subsidies:** Expenditure on food, fertilisers and petroleum, form the largest share of Government's expenditure along with interest payments. The expenditure on these items (Food, Fuel, Fertilizers) soared to ~3% of GDP in FY2020-21. For FY2022-23, the subsidy bill on these three heads is expected to be INR 532,446.79 crore: Food (INR 287,179.34 crore), fertiliser (INR 214,511.27 crore) and petroleum (INR 30,756.18 crore).

**Off-budget Financing:** Economists and analysts argue that the **actual fiscal deficit figures might be even higher** because some of the government's expenditure is funded by the so-called "off-budget" items. (The off-budget borrowings are loans that government does not take directly, but public institutions borrow after the Government's order). This extra expenditure does not figure in the official calculations. This means that the true fiscal deficit is higher than the level presented in the Budget.

**Debt-to-GDP Ratio:** India's debt ratio is projected to be 84% of its GDP by the end of 2022, which is higher than many emerging economies. Due to this there is **increase in interest payment**. Interest payment of the government has increased to 3.1% of the GDP to INR 7.31 lakh crore in 2021-22.

## Others

**Poor Bond Market:** In the developed economies, the Bond Markets are mature and developed. The Bond Markets judge the sustainability of the borrowing of a Central/State/Local Government and demand higher interest rates when public finance is on an unsustainable path. Such a system is healthy as **fiscal responsibility is rewarded by cheaper debt financing** (i.e., Government can borrow at lower interest rates) and vice versa. Poorly developed bond markets in India lack the ability to act like this check-and-balance. When the government needs to borrow, it forces financial firms (like banks) to lend to it.

## What are the reasons for non-adherence to the FRBM Act?

**Escape Clause:** The term 'Escape Clause' refers to the circumstance in which the Central Government **can deviate from fiscal deficit targets**. The FRBM Act has defined three conditions upon which the escape clause can be invoked: **(a) Over-riding considerations of national security, acts of war, and calamities of national proportion and collapse of agriculture** severely affecting farm output and incomes; **(b) Far-reaching structural reforms** in the economy with unanticipated fiscal implications; **(c) A sharp decline in real output growth** of at least 3 percentage points below the average for the previous four quarters. Because of this clause, the goal posts for fiscal targets have been moved multiple times over the course of the past two decades.

**Amendments to FRBM Act:** Amendments to the FRBM Act are permissible through money bills, which include Finance Bills. This makes it easier to amend the Act and shift the target

dates e.g., the date of eliminating Revenue Deficit was gradually shifted through amendments in 2004, 2012, 2015 and 2018.

**Effectiveness of Fiscal Responsibility Framework:** In the US, the Government shuts down when the Budget negotiation is not able to fit within the debt ceiling. In Germany, the ‘**Federal Debt Brake**’ is in the Constitution, and there would be a shutdown of government payments if it were violated. Such overarching clause is missing in the FRBM Act.

### **What are the harmful impacts of high Fiscal Deficit?**

**Crowding-out:** Due to high fiscal deficit, the Government borrows from financial institutions. This reduces the financing available to private sector. This **reduces private investments, slowing down the economic growth rate.**

**Higher Interest Rates:** Higher borrowing by Government reduces the financing available in the market (demand exceeds supply). This raises interest rates.

**Inflation:** To cover its fiscal deficit, the Government also borrows from the Central Bank. When the Central Bank prints money to finance the government, the economy’s money supply expands, causing inflationary pressures.

**Debt Trap:** Persistent fiscal deficit and dependence of borrowing may lead to accumulation of debt. As the debt rises, the interest payments on cumulative debt rise, putting further pressure on Government finance. Ultimately it may create a vicious cycle with the Government entangled in a **debt trap** where it has to **borrow more money to just repay existing debt and interest payments.**

**External Dependence:** Financing Fiscal Deficit through borrowings from abroad may force the Government to borrow from abroad. This creates dependence on foreign financial institutions and Governments. There is also risk of ballooning of debt in the event of **domestic currency depreciation.**

### **What steps can be taken to address Fiscal Deficit?**

**First,** The Government should focus on **rationalizing the subsidies.** The tendency to grant ‘freebies’ should be kept in check. The subsidies can be made **more targeted.** Checking leakages and diversions can also help in rationalizing the spending.

**Second,** The Government should also improve the tax system. **Tax-to-GDP ratio must be improved** by ensuring better compliance (~4% pay Income Tax). In addition, **introduction of Wealth Tax** and raising the rate of **Property Tax** can reduce the asymmetry with respect to Direct and Indirect Taxes. Laws regarding **tax evasion** must be made more robust and implementation strengthened.

**Third,** The Government can also enhance revenues through **monetization of assets** especially idle assets like land lying vacant with Government entities.

**Fourth**, The Government should adhere to the recommendations regarding **fiscal consolidation** given by the **15th Finance Commission**.

**Fifth**, The amendments to the FRBM Act regarding shifting of target dates should be debated in the Parliament. The Government should adhere to the Act and the costs of deviation from the provisions of the Act should be increased.

### **Conclusion**

The Government had to enhance its spending during the pandemic. Breach from fiscal consolidation targets is justified in such circumstances. However, even during the normal times, the fiscal deficit has never been below 3% since 2007-08. As normalcy returns post COVID-19 pandemic, the Government must focus on fiscal consolidation and bringing down the Fiscal Deficit to more sustainable level at the earliest.

PR GOVT COLLEGE(A), KAKINADA

Budget of Central Government 2022-23

Budget at a glance 2022-23

<b>Actuals 2020-21</b>	<b>Budgeted 2021-22</b>	<b>Revised 2021-22</b>	<b>Budgeted 2022-23</b>	<b>% change (RE 2021- 22 to BE 2022-23)</b>
Revenue Expenditure	30,83,519	29,29,000	31,67,289	31,94,663
Capital Expenditure	4,26,317	5,54,236	6,02,711	7,50,246
Capital Outlay	3,15,826	5,13,862	5,47,457	6,10,189
Loans and Advances	1,10,491	40,374	55,255	1,40,057
<b>Total Expenditure</b>	<b>35,09,836</b>	<b>34,83,236</b>	<b>37,70,000</b>	<b>39,44,909</b>
Revenue Receipts	16,33,920	17,88,424	20,78,936	22,04,422
Capital Receipts	57,625	1,88,000	99,975	79,291
<i>of which:</i>				
Recoveries of Loans	19,729	13,000	21,975	14,291
Other receipts (including disinvestments)	37,897	1,75,000	78,000	65,000
<b>Total Receipts (excluding borrowings)</b>	<b>16,91,545</b>	<b>19,76,424</b>	<b>21,78,911</b>	<b>22,83,713</b>
Revenue Deficit	14,49,599	11,40,576	10,88,352	9,90,241
<b>% of GDP</b>	<b>7.3%</b>	<b>5.1%</b>	<b>4.7%</b>	<b>3.8%</b>
Fiscal Deficit	18,18,291	15,06,812	15,91,089	16,61,196
<b>% of GDP</b>	<b>9.2%</b>	<b>6.8%</b>	<b>6.9%</b>	<b>6.4%</b>

Primary Deficit	11,38,422	6,97,111	7,77,298	7,20,545
<i>% of GDP</i>	<b>5.8%</b>	<b>3.1%</b>	<b>3.3%</b>	<b>2.8%</b>

Source: Budget at a Glance, Union Budget Documents 2022-23;

### Budget Highlights

- **Expenditure:** The government proposes to spend Rs 39,44,909 crore in 2022-23, which is an increase of 4.6% over the revised estimate of 2021-22. In 2021-22, total expenditure is estimated to be 8.2% higher than budget estimate.
- **Receipts:** The receipts (other than borrowings) in 2022-23 are expected to be to Rs 22,83,713 crore, an increase of 4.8% over revised estimate of 2021-22. In 2021-22, total receipts (other than borrowings) are estimated to be 10.2% higher than the budget estimates.
- **GDP:** The government has estimated a nominal GDP growth rate of 11.1% in 2022-23 (i.e., real growth plus inflation).
- **Deficits:** Revenue deficit in 2022-23 is targeted at 3.8% of GDP, which is lower than the revised estimate of 4.7% in 2021-22. Fiscal deficit in 2022-23 is targeted at 6.4% of GDP, lower than the revised estimate of 6.9% of GDP in 2021-22 (marginally higher than the budget estimate of 6.8% of GDP). Interest expenditure at Rs 9,40,651 crore is estimated to be 43% of revenue receipts.
- **Extra Budgetary Resources (EBR):** After a number of years, the budget has not relied on EBR or loans from National Small Savings Fund.
- **Ministry allocations:** Among the top 13 ministries with the highest allocations, in 2022-23, the highest percentage increase in allocation is observed in the Ministry of Communications (93%), followed by the Ministry of Road Transport and Highways (52%), and the Ministry of Jal Shakti (25%).

### Main tax proposals in the Finance Bill

- **Income tax:** There is no change in income tax rates for individuals and corporations.
- **Surcharge on Long Term Capital Gains (LTCG):** Currently, the surcharge on LTCG on listed equities and equity mutual funds is capped at 15%. The surcharge on other LTCG is 25% if total income is between Rs 2 crore and Rs 5 crore, and 37% if it is above Rs 5 crore. The budget proposes to cap these at 15%.
- **Tax on virtual digital assets:** Income from the transfer of cryptocurrencies and non-fungible tokens will be taxed at the rate of 30%. Any loss incurred from such transfers cannot be set off against any other income or carried forward to subsequent years.
- **Updating return of income:** Taxpayers will be permitted to file an updated return of income within two years of the assessment year. They will have to pay 25% penalty on tax and interest due

if it is filed in the year after the assessment year, and 50% penalty in the second year.

- **Co-operatives:** Alternate minimum tax for co-operatives will be reduced from 18.5% to 15%. Surcharge will be reduced from 12% to 7% for co-operatives whose total income is between one crore and ten crore rupees.
- **New companies and start-ups:** New domestic companies engaged in manufacturing have an option to pay tax at 15% (without claiming any deductions) if they start manufacturing by March 31, 2023. Certain types of start-ups have an option for tax holiday for three out of the first ten years if they incorporate by April 1, 2022. Both these deadlines have been extended by one year.
- **Changes in customs duty:** Customs duties on over 500 items have been changed. Many customs exemptions are also being phased out.

### Non-tax proposals in the Finance Bill

- **The Reserve Bank of India Act, 1934** is being amended to enable RBI to issue its digital currency.

### Policy Highlights

- **Legislative proposals:** The Special Economic Zones Act, 2005 will be replaced with a new legislation that will enable states to become partners in 'Development of Enterprise and Service Hubs', covering all existing and new industrial enclaves. Legislative changes will also be brought in to promote agro-forestry and private forestry. Amendments will be made in the Insolvency and Bankruptcy Code to facilitate cross border insolvency resolution.
- **Fiscal Management:** Rs 51,971 crore has been budgeted in 2021-22 towards settling the liabilities of Air India.
- **MSMEs:** Emergency Credit Line Guarantee Scheme (ECLGS) will be extended up to March 2023 and its guarantee cover will be expanded by Rs 50,000 crore to total cover of five lakh crore rupees. Credit Guarantee Trust for Micro and Small Enterprises will be revamped to facilitate additional credit of two lakh crore rupees.
- **Health and Nutrition:** Under Ayushman Bharat Digital Mission, an open platform for National Digital Health Ecosystem will be established. It will consist of digital registries of health providers and health facilities, unique health identity, consent framework, and universal access to health facilities. A National Tele Mental Health Programme will be launched to provide access to quality mental health counselling and care services.
- **River linking:** The Ken-Betwa Link Project will be implemented at an estimated cost of Rs 44,605 crore. Five more river linking projects are being implemented.
- **Labour and Employment:** The Digital Ecosystem for Skilling and Livelihood (DESH) Stack e-portal will be launched. The portal will help citizens learn skills, acquire credentials, and assist in finding relevant jobs.
- **Infrastructure:** Projects relating to transport and logistics infrastructure in the National Infrastructure Pipeline will be aligned with PM GatiShakti framework, which was launched last year. The Prime Minister's Development Initiative for North-East (PM-DevINE) will be

implemented through the North-Eastern Council to fund development projects in the North-East region. Also, one lakh crore rupees is being allocated to states for catalysing investments, in the form of 50 year interest free loans.

- **Roadways:** The PM GatiShakti Master Plan for Expressways will be formulated in 2022-23. The National Highways network will be expanded by 25,000 km in 2022-23.
- **Railways:** One-station-one-product concept will be implemented to help local businesses and supply chains. 400 new Vande Bharat trains will be developed and manufactured during the next three years. Further, 100 cargo terminals for multimodal logistics facilities will also be developed during the next three years.
- **Telecom:** Spectrum auctions will be conducted to facilitate rollout of 5G mobile services within 2022-23. A scheme for design-led manufacturing will be launched to build an ecosystem for 5G as part of the Production Linked Incentive (PLI) Scheme.
- **Energy and Environment:** A battery swapping policy for electric vehicles will be implemented. Four pilot projects for coal gasification and conversion of coal into chemicals required for the industry will be set-up. Sovereign Green Bonds will be issued in 2022-23 for mobilising resources for green infrastructure.

#### Budget estimates of 2022-23 as compared to revised estimates of 2021-22

**Total Expenditure:** The government is estimated to spend Rs 39,44,909 crore during 2022-23. This is an increase of 4.6% over the revised estimate of 2021-22. Out of the total expenditure, revenue expenditure is estimated to be Rs 31,94,663 crore (0.9% increase) and capital expenditure is estimated to be Rs 7,50,246 crore (24.5% increase). The increase in capital expenditure is mainly due to a substantial increase in loans and advances to state governments. Loans and advances by the central government are estimated to be Rs 1,40,057 crore in 2022-23, an increase of 153% over the revised estimates for 2021-22.

**Total Receipts:** Government receipts (excluding borrowings) are estimated to be Rs 22,83,713 crore, an increase of 4.8% over the revised estimates of 2021-22. The gap between these receipts and the expenditure will be plugged by borrowings, budgeted to be Rs 16,61,196 crore, an increase of 4.4% over the revised estimate of 2021-22.

**Transfer to states:** The central government will transfer Rs 16,11,781 crore to states and union territories in 2022-23. This is a marginal increase of 0.5% over the revised estimates of 2021-22. Transfer to states comprises: (i) devolution of Rs 8,16,649 crore out of the divisible pool of central taxes, and (ii) Rs 7,95,132 crore in the form of grants and loans. In 2021-22, as per the revised estimates, Rs 1,59,000 crore will be transferred to states in the form of back-to-back loans in lieu of GST compensation.

**Deficits:** Revenue deficit is targeted at 3.8% of GDP, and fiscal deficit is targeted at 6.4% of GDP in 2022-23. The target for primary deficit (which is fiscal deficit excluding interest payments) in 2021-22 is 2.8% of GDP.

**GDP growth estimate:** The nominal GDP is estimated to grow at a rate of 11.1% in 2022-23.

#### Fiscal Responsibility and Budget Management targets

The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 requires the central government to progressively reduce its outstanding debt, revenue deficit and fiscal deficit. The central government gives three year rolling targets for these indicators when it presents the Union Budget each year. Note that the Medium Term Fiscal Policy Statement in both 2021-22 and 2022-23 did not provide rolling targets for budget deficits. In the Budget speech, the finance minister noted that the government aims to reduce fiscal deficit to below 4.5% of GDP by 2025-26.

**Fiscal deficit** is an indicator of borrowings by the government for financing its expenditure. The estimated fiscal deficit for 2022-23 is 6.4% of GDP.

**Revenue deficit** is the excess of revenue expenditure over revenue receipts. Such a deficit implies the government's need to borrow funds to meet expenses which may not provide future returns. The estimated revenue deficit for 2022-23 is 3.8% of GDP.

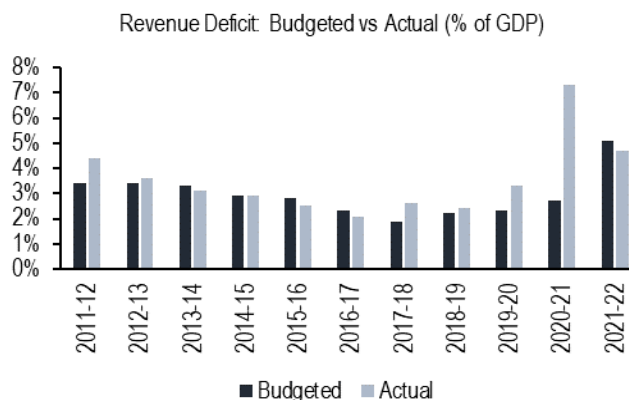
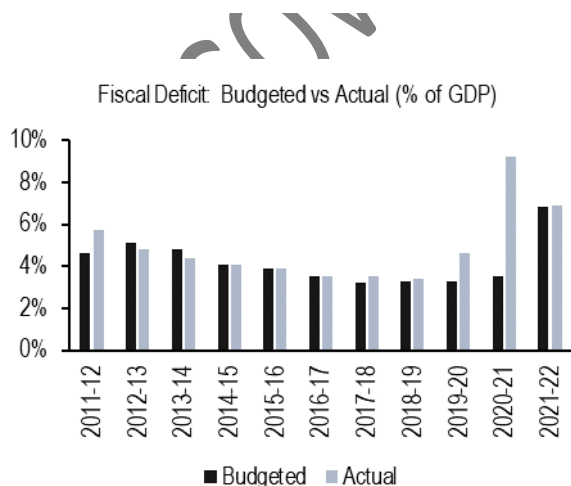
**FRBM targets for deficits (as % of GDP)**

	Actuals 2020- 21	Revised 2021- 22	Budgeted 2022-23
<b>Fiscal Deficit</b>	9.2%	6.9%	6.4%
<b>Revenue Deficit</b>	7.3%	4.7%	3.8%
<b>Primary Deficit</b>	5.8%	3.3%	2.8%

Sources: Medium Term Fiscal Policy Statement, Union Budget 2022-23; PRS.

In 2021-22, the government had set a budget estimate of 6.8% of GDP for fiscal deficit, and 5.1% of GDP for revenue deficit. As per the revised estimates, the fiscal deficit is expected to marginally exceed the budget estimate to 6.9% while revenue deficit is estimated to be lower at 4.7%.

**Primary deficit** is the difference between fiscal deficit and interest payments. It is estimated to be 2.8% of GDP in 2022-23.



Conclusion: The budget for 2022-23 and the government's decisions in the last two years reveal a

fiscal strategy for growth that seems to comprise three Ps: protectionism through increasing tariffs, incentives to increase production, and projects to create infrastructure by the government to raise demand and crowd in private investments.

## Deficit Financing

Deficit financing is the budgetary situation where expenditure is higher than the revenue. It is a practice adopted for financing the excess expenditure with outside resources. In this process, the government knows well in advance that its total expenditures are going to turn out to be more than its total receipts and enacts/follows such financial policies so that it can sustain the burden of the deficits proposed by it.

Nowadays most governments both in the developed and developing world are having deficit budgets and these deficits are often financed through borrowing. Hence the fiscal deficit is the ideal indicator of deficit financing.

In India, deficit financing is defined as “borrowings from the Reserve Bank of India against the issue of Treasury Bills and running down of accumulated cash balances”. When the government borrows from the Reserve Bank of India, it merely transfers its securities to the Bank. On the basis of these securities the bank issues more currency and puts them into circulation on behalf of the government. This amounts to the creation of money.

### Why we need deficit financing

- For developing countries like India, higher economic growth is a priority. A higher economic growth requires finances. With the private sector being shy of making huge expenditure, the responsibility of drawing financial resources rests on the government.
- Being poor, these countries fail to mobilize large resources through taxes. Thus, taxation has a narrow coverage due to mass poverty. A very little is saved by people because of poverty. In order to collect financial resources, government relies on profits of public sector enterprises. But these enterprises yield almost negative profit. Further, there is a limit to public borrowing.
- India tried its hand at deficit financing in 1969 and since the 1970s it became a routine phenomenon, till it became wild and illogical, demanding immediate redressal. The fiscal deficits in India did not only peak to unsustainable levels but its composition was also not justified and not based on sound fundamentals of economics. Finally, India headed for a slow but confident process of fiscal reforms that is also known as the process of fiscal consolidation.
- There are some situations when deficit financing becomes absolutely essential. In other words, there are various purposes of deficit financing. **These are:**
  1. To finance defence expenditures during war
  2. To lift the economy out of depression so that incomes, employment, investment, etc., all rise

3. To activate idle resources as well as divert resources from unproductive sectors to productive sectors with the objective of increasing national income and, hence, higher economic growth
4. To raise capital formation by mobilizing forced savings made through deficit financing
5. To mobilize resources to finance massive plan expenditure

### Different Means of Deficit Financing

These means are given below in order of their suggested and tried preferences.

1. **External Aids** are the best money as a means to fulfil a government's deficit requirements even if it is coming with soft interest. If they are coming without interest nothing could be better. External Grants are even better elements in this case (which comes free—neither interest nor any repayments) but it either did not come to India (since 1975, the year of the first Pokhran testings) or India did not accept it (as happened post-Tsunami, arguing grants/aids coming with a tag/condition).
2. **External Borrowings** are the next best way to manage fiscal deficit with the condition that the external loans are comparatively cheaper and long-term. Though external loans are considered an erosion in the nation's sovereign decision making process, this has its own benefit and is considered better than the internal borrowings due to two reasons:
  - (a) External borrowing bring in foreign currency/hard currency which gives extra edge to the government spending as by this the government may fulfil its developmental requirements inside the country as well as from outside the country.
  - (b) It is preferred over the internal borrowings due to 'crowding out effect'. If the government itself goes on borrowing from the banks of the country, from where will others borrow for investment purposes?
3. **Internal Borrowings** come as the third preferred route of fiscal deficit management. But going for it in a huge way hampers the investment prospects of the public and the corporate sector. It has the same impact on the expenditure pattern in the economy. Ultimately, economy heads for a double negative impact—lower investment (leading to lower production, lower GDPs and lower per capita income, etc.) and lower demands (by the general public as well as by the corporate world) in the economy—the economy moves either for stagnation or for a slowdown (one can see them happening in India repeatedly throughout the 1960s, 1970s, 1980s). The situation improved after the mid-1990s.
4. **Printing Currency** is the last resort for the government in managing its deficit. But it has the biggest handicap that with it the government cannot go for the expenditures which are to be made in the foreign currency. Even if the government is satisfied on this front, printing fresh currencies does have other damaging effects on the economy:
  - (a) It increases inflation proportionally. (India regularly went for it since the early 1970s and usually had to bear double digit inflations.)
  - (b) It brings in regular pressure and obligation on the government for upward revision in wages and salaries of government employees—ultimately increasing the government expenditures necessitating further printing of currency and further

inflation—a vicious cycle into which economies entangle themselves. Now, it remains a matter of choice and availability of the above-given means, and which means a government adopts and in what proportion, for fulfilling its deficit requirements.

### **Advantages and Disadvantages of Deficit Financing:**

#### **(a) Advantages:**

1. Massive expansion in governmental activities has forced governments to mobilize resources from different sources. As a source of finance, tax-revenue is highly inelastic in the poor countries. Above all, governments in these countries are rather hesitant to impose newer taxes for the fear of losing popularity. Similarly, public borrowing is also insufficient to meet the expenses of the state.
2. In India, deficit financing is associated with the creation of additional money by borrowing from the Reserve Bank of India. Interest payments to the RBI against this borrowing come back to the Government of India in the form of profit. Thus, this borrowing or printing of new currency is virtually a cost-free method. On the other hand, borrowing involves payment of interest cost to the lenders.
3. Financial resources (required for financing economic plans) that a government can mobilize through deficit financing are certain and known beforehand. The financial strength of the government is determinable if deficit financing is made. As a result, the government finds this measure handy.
4. Deficit financing has certain multiplier effects on the economy. This method encourages the government to utilize unemployed and underemployed resources. This results in more incomes and employment in the economy.
5. Deficit financing is an inflationary method of financing. However, the rise in prices must be a short run phenomenon. Above all, a mild dose of inflation is necessary for economic development. Thus, if inflation is kept within a reasonable level, deficit financing will promote economic development—thereby neutralizing the disadvantages of price rise.
6. During inflation, private investors go on investing more and more with the hope of earning additional profits. Seeing more profits, producers would be encouraged to reinvest their savings and accumulated profits. Such investment leads to an increase in income—thereby setting the process of economic development rolling.

#### **(b) Disadvantages:**

1. It is a self-defeating method of financing as it always leads to inflationary rise in prices. Unless inflation is controlled, the benefits of deficit-induced inflation would not fructify. And, underdeveloped countries—being inflation-sensitive countries—get exposed to the dangers of inflation.
2. Deficit financing-led inflation helps producing classes and businessmen to flourish. But fixed-income earners suffer during inflation. This widens the distance between the two classes. In other words, income inequality increases.
3. It distorts investment pattern. Higher profit motive induces investors to invest their resources in quick profit-yielding industries. Of course, investment in such industries is not desirable in the interest of a country's economic development.

4. Deficit financing may not yield good result in the creation of employment opportunities. Creation of additional employment is usually hampered in backward countries due to lack of raw materials and machineries even if adequate finance is available.
5. As purchasing power of money declines consequent upon inflationary price rise, a country experiences flight of capital abroad for safe return—thereby leading to a scarcity of capital.
6. This inflationary method of financing leads to a larger volume of deficit in a country's balance of payments. Following inflationary rise in prices, export declines while import bill rises, and resources get transferred from export industries to import- competing industries.

***Conclusion:***

Much success of deficit financing depends on how anti-inflationary measures are employed to combat inflation. Most of the disadvantages of deficit financing can be minimized if inflation is kept within limit.

It is an evil but a necessary one. Considering the needs of the economy, its use cannot be discouraged. But considering the effects of deficit financing on the economy, its use must be made limited. So, a compromise has to be made so that the benefits of deficit financing are reaped too.

<https://panaceaconcept.in/all-you-should-know-about-the-deficit-financing/>

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