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Importance and Role of Fiscal Policy in Economic Development in India- Its advantages and disadvantages

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Abstract:
The economy does not always work smoothly. There often occurs fluctuations in the level of economic activities. At times the economy finds itself in the grip of recession when levels of national income, output and employment are far below their full potential levels. During recession, there is a lot of idle or unutilized productive capacity, that is, available machines and factories are not working to their full capacities. As a result, unemployment of labour increases along with the existence of excess capital stock. On the other hand, at times the economy is 'over heated' which means inflation (i.e. rising prices) occurs in the economy. Thus, in a free market economy there is a lot of economic instability. The classical economists believed that an automatic mechanism works to restore stability in the economy, recession would cure itself and inflation will be automatically controlled.
Macro economic policy refers to the instrument by which a government tries to regulate or modify the economic affairs of the country in keeping with certain objectives. In other words, it "attempts to assess the behaviour of the economy as a whole and to seek ways in which its aggregate performance might be improved". These are achieved through certain tools of macro economic policy. According to Keynes, Monetary policy was ineffective to lift the economy out of depression. He emphasized the role of fiscal policy as an effective tool of stabilizing the economy. However, in view of the modern economists both fiscal and monetary policies play a useful role in stabilizing the economy.
Monetary policy is conducted by the central bank of a country. Fiscal policy is conducted by the Executive and legislative branches of the government and deals with managing a nation's budget. Monetary and fiscal policies are generally thought of as demand management policies. The purpose of monetary and fiscal policy, taken together is to maintain demand roughly equal to supply in the economy and to maintain the existing price level. The appearance of excess demand will probably cause inflation, while an insufficiency of demand will bring at least temporary unemployment and deflation.

Fiscal Policy

The most important instrument of government intervention in the economy today is that of fiscal or budgetary policy. Fiscal policy refers to the taxation, expenditure and borrowing by the government. The economists now hold the government intervention through fiscal policy is essential in the matter of overcoming recession or inflation as well as of promoting and accelerating economic growth.

Meaning:-

The fiscal policy is concerned with the raising of government revenue and incurring of government expenditure. The government frames a policy called budgetary policy or fiscal policy. So, the fiscal policy is concerned with government expenditure and government revenue. Fiscal policy has to decide on the size and pattern of flow of expenditure from the government to the economy and from the economy back to the government.

Definitions:-

According to ***J.M. Culbertson,*** "By fiscal policy we refer to government actions affecting its receipts and expenditures which we ordinarily takes as measured by the government's net receipts, its surplus or deficit." The Government may offset undesirable variations in private consumption and investment by anti-cyclical variations of public expenditures and taxes.

Arthur smithies defines fiscal policy as "a policy under which the government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production and employment." Though the ultimate aim of fiscal policy is the long run stabilisation of the economy, yet it can only be achieved by moderating short run economic fluctuations.

Otto Eckstein defines fiscal policy as "Changes in taxes and expenditures which aim at short run goals of full employment and price -level stability."

Objectives of Fiscal Policy

The importance of fiscal policy is high in underdeveloped countries. The state has to play active and important role. In a democratic society direct methods are not approved. So, the government has to depend on indirect methods of regulations. In this way, fiscal policy is a powerful weapon in the hands of government by means of which it can achieve the objectives of development. The principle objectives of fiscal policy are given below :-

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.

2. Efficient Allocation of Financial Resources :-

The central and state governments have tried to make efficient allocation of financial resources. These resources are allocated for development activities which includes expenditure on railways, infrastructure, etc. While non-development activities includes expenditure on defence, interest payments, subsidies, etc.

3. 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.

4. Price Stability and Control of Inflation:-

One of the main objective 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.

5. Employment Generation:-

The government is making every possible effort to increase employment in the country through effective fiscal measure. Investment in infrastructure has resulted in direct and indirect employment. Lower taxes and duties on small-scale industrial (SSI) units encourage more investment and consequently generates more employment.

6. Balanced Regional Development :-

Another main objective of the fiscal policy is to bring about a balanced regional development. There are various incentives from the government for setting up projects in backward areas such as cash subsidy, concession in taxes and duties in the form of tax holidays, finance at concessional interest rates, etc.

7. Capital Formation

The objective of fiscal policy is to increase the rate of capital formation so as to accelerate the rate of economic growth. An underdeveloped country is trapped in vicious circle of poverty mainly on account of capital deficiency. In order to increase the rate of capital formation, the fiscal policy must be efficiently designed to encourage savings and discourage and reduce spending.

8. Increasing National Income

The fiscal policy aims to increase the national income of a country. This is because fiscal policy facilitates the capital formation. This results in economic growth, which in turn increases the GDP, per capita income and national income of the country.

9. Development of Infrastructure

Government has placed emphasis on the infrastructure development for the purpose of achieving economic growth. The fiscal policy measure such as taxation generates revenue to the government. A part of the government's revenue is invested in the infrastructure development. Due to this, all sectors of the economy get a boost.

Role of Fiscal Policy in Economic Development:-

One of the important goals of fiscal policy formulated by the Government of India is to attain rapid economic development of the country.

To attain such economic development in the country, the fiscal policy of the country has adopted following two objectives:-

1. To raise the rate of productive investment of both public and private sector of the country.
2. To enhance the marginal and average rates of savings for mobilising adequate financial resources for making .investment in public and private sectors of the economy.

The fiscal policy of the country is trying to attain both these two objectives during the plan periods.

Merits or Advantages of Fiscal Policy of India:

Following are some of the important merits or advantages of fiscal policy of Government of India:-

(i) Capital Formation:-

Fiscal policy of the country has been playing an important role in raising the rate of capital formation in the country both in its public and private sectors. The gross domestic capital formation as per cent of GDP in India increased from 8.4 per cent in 1950-51 to 19.9 per cent in 1980-81 and then to 39.1 per cent in 2007-08. Therefore, it has created a favourable impact on the public and private sector investment of the country.

(ii) Mobilisation of Resources:-

Fiscal policy of the country has been helping to mobilise considerable amount of resources through taxation, public debt etc. for financing its various developmental projects. The extent of internal resource mobilisation for financing plan increased considerably from 70 per cent in 1965- 66 to around 90 per cent in 1997-98.

(iii) Incentives to Savings:-

The fiscal policy of the country has been providing various incentives to raise the savings rate both in household and corporate sector through various budgetary policy changes, viz., tax exemption, tax concession etc. The saving rate increased from a mere 8.6 per cent in 1950-51 to 37.7 per cent in 2007-08.

(iv) Inducement to Private Sector:-

Private sector of the country has been getting necessary inducement from the fiscal policy .of the country to expand its activities. Tax concessions, tax exemptions, subsidies etc. incorporated in the budgets have been providing adequate incentives to the private sector units engaged in industry, infrastructure and export sector of the country.

(v) Reduction of Inequality:-

Fiscal policy of the country has been making constant endeavour to reduce the inequality in the distribution of income and wealth. Progressive taxes on income and wealth tax exemption, subsidies, grant etc. are making a consolidated effort to reduce such inequality. Moreover, the fiscal policy is also trying to reduce the regional disparities through its various budgetary policies.

(vi) Export Promotion:-

The Fiscal policy of the Government has been making constant endeavour to promote export through its various budgetary policy in the form of concessions, subsidies etc. As a result, the growth rate of export has increased from a mere 4.6 per cent in 1960-61 to 10.4 per cent in 1996-97.

(vii) Alleviation of Poverty and Unemployment:-

Another important merit of Indian fiscal policy is that it is making constant effort to alleviate poverty and unemployment problem through its various poverty eradication and employment generation programmes, like, IRDP, JRY, PMRY, SJSRY, EAS, NREGA etc.

Shortcomings of Fiscal Policy in India:-

(i) Instability:-

Fiscal policy of the country has failed to attain stability on various fronts. Growing volume of deficit financing has created the problem of inflationary rise in price level. Disequilibrium in its balance of payments has also affected the external stability of the country.

(ii) Defective Tax Structure:-

Fiscal policy has also failed to provide a suitable tax structure for the country. Tax structure has failed to raise the productivity of direct taxes and the country has been relying much on indirect taxes. Therefore, the tax structure has become burdensome to the poor.

(iii) Inflation:-

Fiscal policy of the country has failed to contain the inflationary rise in price level. Increasing volume of public expenditure on non-developmental heads and deficit financing has resulted in demand-pull inflation. Higher rate of indirect taxation has also resulted in cost-push inflation.

(iv) Negative Return of the Public Sector:-

The negative return on capital invested in the public sector units has become a serious problem for the Government of India. In-spite of having a huge total investment to the extent of Rs 4,21,089 crore in 2007 on PSUs the return on investment has remained mostly negative or lower.

(v) Growing Inequality:-

Fiscal policy of the country has failed to contain the growing inequality in the distribution of income and wealth throughout the country. Growing trend of tax evasion has made the tax machinery ineffective for the purpose. Growing reliance on indirect taxes has made the tax structure regressive.

Techniques of Fiscal Policy:-

(i) 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 mobilising resources for plan.

(ii) Public Expenditure Policy of Government of India:-

Public expenditure is playing an important role in the economic development of a country like India. With 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.

(iii) 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.

(iv) 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 mobilise a huge amount of resources for meeting its developmental expenditure. Total public debt of the Central Government includes internal debt and external debt.

Measures of Fiscal Policy Reforms:-

The Government of India has introduced several fiscal policy reforms which constitute the main basis of the stabilisation policy of the country. Following are some of the important measures of fiscal policy reforms adopted by the Government of India in recent years:

(i) Reduction of Rates of Direct Taxes:-

The peak rate of income tax was reduced to 30 per cent in 1997-98 budget. This has resulted in an increase in the share of direct taxes in total revenue of the country from 19 per cent in 1990-91 to around 61 per cent in 2008-09.

(ii) Fall in the volume of Government Expenditure:-

Several measures were undertaken recently by the government. Accordingly, total expenditure of the Government under various heads has been reduced. As a result, total public expenditure as per cent of GDP has declined from 19.7 per cent of GDP in 1990-91 to 16.9 per cent in 2008-09.

(iii) Reduction in the Volume of Subsidies:-

Central Government has been making huge payments in the form of subsidies, i.e., food subsidies, fertiliser subsidies, export subsidies etc. Steps have been taken to reduce these subsidies in a phased manner.

(iv) Reduction in Fiscal Deficit:-

The Central Government has been trying seriously to contain the fiscal deficit in its annual budget. Accordingly, it has reduced the extent of fiscal deficit from 7.7 per cent of GDP in 1990-91 to 6.1

per cent in 2008-09. But fiscal stabilisation necessitates containing the fiscal deficit at least to 3 per cent of GDP.

(v) Reduction in Public Debt:-

Recently, the Central Government has been trying to reduce the burden of public debt. Accordingly, the external debt as per cent of GDP which was 5.4 per cent in 1990-91 gradually declined to 4.9 per cent in 2008-09. The internal debt as per cent of GDP has declined from 48.6 per cent in 1990-91 to 37.9 per cent in 2008-09.

Similarly, the total outstanding loan or liabilities as per cent of GDP also declined from 63.0 per cent in 2003-04 to 58.9 per cent in 2008-09.

Suggestions for Necessary Reforms in Fiscal Policy:-

(i) Progressive Taxes:-

The tax structure of the country should try to infuse more progressive elements so that it can put heavy burden on the rich and less burden on the poor. Necessary amendments should be made in respect of irrigation tax, sales tax, excise duty, land revenue, property taxes etc.

(ii) Agricultural Taxation:-

The tax net of the country should be extended to the agricultural sector for rapping a huge amount of revenue from the rich agriculturists.

(iii) Broad-based Tax Net:-

Tax net of the country should be broad-based so that it can cover increasing number of population having the taxable capacity.

(iv) Checking Tax Evasion:-

Adequate measures be taken to check the problem of tax evasion in the country. Tax laws should be made stricter for prosecuting the tax evaders. Tax machinery should be made more efficient and honest to gear up its operations. Tax rate should be reduced to encourage the growing trend of tax compliance.

(v) Increasing Reliance on Direct Taxes:-

Tax machinery of the country should attach much more reliance on direct taxes instead of indirect taxes. Accordingly, the tax machinery should try to introduce wealth tax, estate duty, gift tax, expenditure tax etc.

(vi) Simplified Tax Structure:-

Tax structure and rules of the country should be simplified so that it can encourage tax compliance among the people and it can remove the unnecessary harassment of the tax payers.

Conclusion

The objectives of fiscal policy such as economic development stability, Social Justice, etc. can be achieved only if the tool of policy life public expenditure, taxation, borrowing and deficit financing are effectively used.

Though there are gaps in Indian fiscal policy, there is also an urgent need for making Indian fiscal policy rationalized and growth oriented one.

The success of fiscal policy depend upon taking timely measure and their effective administration during implementation.

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