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FISCAL DEFICIT AND ECONOMIC GROWTH

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Much has been happened in the last 65 years since independence. The people of India have conclusively demonstrated their ability to forge a nation united despite its diversity, and their commitment to pursue development within the framework of a functioning, vibrant and highly pluralistic democracy. In this process democratic institutions have put down firm roots and flourished and development has also taken place on a wide front. As we entered in the 21st Century, the time has come to redouble our efforts at development, especially in the social and economic spheres, so that the country will realize its full destiny in an unfettered manner. This will require not only higher rates of growth of output and employment, but also a special emphasis on all round human development, with stress on social sectors and a thrust on eradication of poverty.

“On the one hand, the government has to raise public spending to boost the economy; on the other, the fiscal deficit has to be controlled to avoid its ill effects. The expansionary fiscal policy of the last two years, it has been argued, cannot continue and an exit strategy will have to be put in place in the forthcoming budget to ensure fiscal sustainability and greater flexibility in monetary policy operation, enhance the productivity of public spending, and avoid pressure on interest rates” (Govinda Rao 2009; Rangarajan 2009; Kumar 2009).

In consonance with the above statement it is necessary to study the fiscal problem in the different way. The fiscal policy assumes centre stage in policy deliberations as the continuous fiscal imbalances and rising levels of public debt pose risks to the prospects for macroeconomic stability, and accelerating and sustaining growth.

The first surge in India’s economic growth rate came in the early 1980s, when it increased to above 5% from the average “Hindu” growth rate of 3.5% in earlier decades. Unfortunately, this spurt was achieved by unsustainable fiscal expansion financed by domestic credit and external borrowing. Growth accelerated to 5.8% during the 1980s, but in the second half of the decade, fiscal and current account deficits widened significantly, causing serious macroeconomic imbalances and culminating in the balance of payment (BOP) crisis of 1991. These triggered the series of economic reforms that have been introduced, starting in 1991, to bring about macroeconomic stabilization and implement structural measures to push up the growth.

The “Hindu” rate of growth is a controversial expression coined by Raj Krishna used to hide the disastrous socialist policies followed by successive Indian National Congress governments. India's low annual growth rate of economy before 1991 was stagnant around 3.5%, and had been so since the 1950s. Structural measures initially emphasized accelerating the process of industrial and import de-licensing simultaneously, with a switch to a flexible exchange rate regime, and then shifted to further trade liberalization, financial sector reforms, and tax reforms.

The fiscal situation of both the centre and state governments remained comfortable till 1980. But there was a significant deterioration in the fiscal situation in 1980's, especially by the second half, which was marked by high and persistent fiscal deficits accompanied by large revenue deficits. This large fiscal deficit had some spill-over effects on the external sector which was reflected in the widening current account deficit in the early 1990s. In fact, there were two sources of external shocks which contributed the most to India's large current account deficit in 1990-91. "The first shock came from events in the Middle East in 1990 and the consequent run up in world oil prices, which helped precipitate the crisis in India. Second, the deterioration of the current account was also induced by slow growth in important trading partners." (Cerra and Saxena, 2002).

In the past also India had experienced macro-economic crisis in the mid-60s, in the mid-70s and in the mid-80s. It was mainly due to supply shocks, both internal and external. “The economic crisis of the mid-sixties owed its origin to two successive droughts of 1965-66 and 1966-67 and the two wars: the Indo-China war of 1962 and the Indo- Pak war of 1965. The second major crisis occurred in the mid-seventies due to the combined effect of monsoon failures of 1972 and 1974, and the first external oil shock. The third major crisis occurred in 1979, again due to the combined effect of bad weather and the second oil shock" (Klein and Palanivel, 2000).

It was only after the crisis of the early 1990s, when India's foreign currency assets depleted rapidly to the extent that it could barely finance just two weeks of imports, India realized the need to start the process of fiscal reforms as a part of economic reform measures in 1991-92.

Fiscal sector reforms were the integral and the most critical part of the macro-economic stabilization and reforms programme taken by the government after 1991 crisis. The primary objective of the fiscal reforms programme was to achieve a reduction in the size of deficit and debt in relation to GDP. The major structural change made during fiscal reforms programme was a step towards decentralization i.e., the conversion of two-tier structure into three-tier structure. With the 73rd and 74th Constitutional Amendments in 1993, roles and responsibilities of rural and urban local governments have been specified. A list of 29 functions to rural local bodies has been specified in a separate list. Another list of 18 functions has been specified for urban local bodies. These functions can be divided into 4 or 5 categories, viz. socio-economic schemes, beneficiary oriented schemes, national policy schemes, infrastructure creating schemes and State or Centrally Sponsored Schemes (Gupta, 2007). This reform is a step towards strengthening the third layer of government in India. After the global financial crisis in 2008-09, the Indian economy responded strongly to fiscal and monetary stimulus and achieved a growth rate of 8.6 per cent and 9.3 per cent respectively in 2009-10 and 2010-11. However, with the economy exhibiting inflationary tendencies, the Reserve Bank of India (RBI) started raising policy rates in March 2010. High rates as well as policy constraints adversely impacted investment, and in the subsequent two years viz. 2011-12 and 2012-13, the growth rate slowed to 6.2 per cent and 5.0 per cent respectively. Despite this slowdown, the compound annual growth rate (CAGR) for gross domestic product (GDP) at factor cost, over the decade ending 2012-13 is 7.9 per cent.

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