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FISCAL POLICY IN INDIA

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ABSTRACT

Fiscal policy is the guiding force that helps the government decide how much money it should spend to support the economic activity, and how much revenue it must earn from the system, to keep the wheels of the economy running smoothly. The paper discusses the important objectives and techniques of fiscal policy adopted by the government of India and some important measures suggested for necessary reforms of the fiscal policy of the country. In recent times, the importance of fiscal policy has been increasing to achieve economic growth swiftly, both in India and across the world.

Keywords: Development, Economic, Expenditure, Financing, Fiscal, Government, India, Inflation, Policy, Private sector, Public sector, Resource, Revenue, Tax

Introduction

Fiscal policy plays an important role on the economic and social front of a country. In India, the fiscal policy is gaining its importance in recent years with the growing involvement of the government in developmental activities of the country. It is the guiding force that helps the government decide how much money it should spend to support economic activity, and how much revenue it must earn from the system, to keep the wheels of the economy running smoothly. In recent times, the importance of fiscal policy has been increasing to achieve economic growth swiftly, both in India and across the world.

According to G.K. Shaw, " We define fiscal policy to include any design to change the price level, composition or timing of government expenditure or to vary the burden, structure or frequency of the tax payment." Otto Eckstein defined fiscal policy as " Changes in taxes and expenditure which aim at short run goals of full employment price level and stability."

Attaining rapid economic growth is one of the key goals of fiscal policy formulated by the Government of India. Fiscal policy, along with monetary policy, plays a crucial role in managing

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a country's economy. Through fiscal policy, the government of a country controls the flow of tax revenues and public expenditure to navigate the economy. If the government receives more revenue than it spends, it runs a surplus, while if it spends more than the tax and non-tax receipts, it runs a deficit. To meet additional expenditures, the government needs to borrow domestically or from overseas. Alternatively, the government may also choose to draw upon its foreign exchange reserves or print additional money.

Historical Background

Fiscal policy was dedicated chiefly to re-distributing wealth from the private sector to the State, and taxing the 'wealthy' to give to the poor until the 1970s. The Shylock-like policies contributed to personal income tax rates as high as 77 per cent, and corporate taxes of 45-75 per cent in the mid-70s. The gross fiscal deficit and borrowings started to climb gradually from the mid-70s to reach a crescendo in 1991, which exposed the country to a full-blown balance of payments crisis during the Gulf War. Fiscal imbalances set in the Indian economy both at the national and sub-national levels during the 1980s and developed into a matter of concern by the end of the last century.

But a study of India's fiscal policies since the 1950s displays that the country has truly come a long way in pruning tax rates and generally progressing towards more sensible government spending.

Objectives

The important objectives of fiscal policy adopted by the government of India are:

I. to mobilize adequate resources for financing various programmes and projects adopted for economic development;

II. to raise the rate of savings and investment for increasing the rate of capital formation;

III. to reduce regional disparities;

IV. to reduce the degree of inequality in the distribution of income and wealth;

V. to promote necessary development in the private sector through fiscal incentive;

VI. to arrange an optimum utilization of resources;

VII. to control the inflationary pressures in economy in order to attain economic stability;

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VIII. to remove poverty and unemployment; and

IX. to attain the growth of the public sector for attaining the objective of the socialistic pattern of society.

The fiscal policy of the country has adopted the following two objectives to attain economic development in the country:

I. to raise the rate of productive investment of both public and private sector of the country; and

II. to enhance the marginal and average rates of savings for mobilizing adequate financial resources for making investment in public and private sectors of the economy.

Techniques

The important techniques of fiscal policy of India are:

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 indirect taxes are regressive in nature. Taxation plays an important role in mobilizing resources for planning.

The main objectives of taxation policy in India are:

a. mobilization of resources for financing economic development;

b. formation of capital by promoting saving and investment through time deposits, investment in government bonds, in units, insurance, etc. ;

c. attainment of equality in the distribution of income and wealth through the impositionof progressive direct taxes; and

d. attainment of price stability by adopting anti-inflationary taxation policy.

II. Public expenditure policy of Government of India:

Public expenditure plays an important role in the economic development of India. With increase in responsibilities of the government and with the increasing participation of government in

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economic activities of the country, the volume of public expenditure in a highly populated country like India is increasing at a galloping rate. 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 non-developmental expenditure is mostly a maintenance type of expenditure and which is related to maintenance of law and order, defense, administrativeservices, etc.

There are some important features of the policy of public expenditure formulated by the Government of India. They are:

a. Social welfare and employment programmes:

This 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.

b. 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.

c. Support to private sector:

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

d. Development of public enterprises:

Development of heavy and basic industries are very important for the development of an underdeveloped country. But the establishment of these industries involves huge investment and a considerable proportion of risk. Naturally the 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.

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III. Policy of deficit financing of Government of India:

The deficit financing in India indicates taking loans by the government from the Reserve Bank of India in the form of issuing fresh doses 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. During the First, Second, Third and Fourth Plan deficit financing as percentage of total plan resources was to the extent of 17%, 20%, 13% and 13.5% respectively. But due to adverse consequences of deficit financing through inflationary rise in price level, the extent of deficit financing was reduced to only 3% during the Fifth Plan. But due to resource constraint, the extent of deficit financing again rose to 14% and 16% 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.

IV. Public debt policy of the government of India:

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.

a. Internal debt:

It 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 and also from commercial banks.

b. External debt:

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

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Advantages

There are certain advantages of fiscal policy of the Government of India. They are:

I. Alleviation of poverty and unemployment:

Fiscal policy of India makes constant efforts to alleviate poverty and unemployment problems through its various poverty eradication and employment generation programmes, like, IRDP, JRY, PMRY, SJSRY, EAS, NREGA, etc.

II. Capital formation:

Indian fiscal policy plays 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 has increased, therefore, creating a favourable impact on the public and private sector investment of the country.

III. Export promotion:

Fiscal policy of the country has been making constant efforts to promote exports through its various budgetary policies in the form of concessions, subsidies, etc. As a result, the growth rate of exports has increased.

IV. Mobilization of resources:

Indian fiscal policy has been helping to mobilize considerable amounts of resources through taxation, public debt, etc. for financing its various developmental projects. The extent of internal resource mobilization for financing plans has also increased considerably.

V. Reduction of inequality:

The Indian fiscal policy 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, grants, etc. are making a consolidated effort to reduce such inequality. The fiscal policy is also trying to reduce the regional disparities through its various budgetary policies.

VI. Incentives to savings:

Fiscal policy of the government has been providing various incentives to raise the savings rate both in the household and corporate sector through various budgetary policy changes viz, tax exemption, tax concession, etc. The savings rate has also increased.

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VII. 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 exemption, 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.

Shortcomings

There are certain shortcomings of the fiscal policy of the Government of India. They are:

I. Growing inequality:

Indian fiscal policy 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.

II. Instability:

The fiscal policy of the government 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.

III. 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 on PSUs the return on investment has remained mostly negative or lower. In order to maintain those PSUs, the government has to keep a huge amount of budgetary provisions, thereby creating a huge drainage of scarce resources of the country.

IV. Defective tax structure:

Indian 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.

V. Inflation:

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Fiscal policy of the government 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. Moreover, the direct taxes have failed to check the growth of black money which is again aggravating the inflationary spiral in the level of prices.

Measures

There are some important measures suggested for necessary reforms of the fiscal policy ofthe country. They are:

I. 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.

II. Checking tax evasion:

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

III. Simplified tax structure:

In order to encourage tax compliance among the people and remove the unnecessary harassment of the taxpayers, tax structure and rules of the country should be simplified.

IV. Checking black money:

Schemes like VDIS should be repeated, corruption and political interference should beabolished, tax rates should be reduced, smuggling and other nefarious activities should be checked, etc.

V. Progressive taxes:

The tax structure should 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.

VI. Broad- based tax net:

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

VII. Increasing reliance on direct taxes:

Tax machinery should attach much more reliance on direct taxes and try to introduce wealth tax, estate duty, gift tax, expenditure tax, etc.

VIII. Reduction of non-development expenditure:

The fiscal policy should try to reduce the volume of productive expenditure and can reduce the inflationary impact of such expenditure.

IX. Raising the profitability of PSUs:

The government policy should be restructured on public sector enterprises so that its efficiency and rate of return on capital invested can be raised effectively. PSUs should be managed in a rational manner and the policy of budgetary provisions for maintaining the PSUs should be eliminated.

There are some important measures of fiscal policy reforms adopted by the Government of India in recent years:

I. reduction of rates of direct taxes;

II. simplification of tax procedure;

III. reforms in indirect taxes;

IV. fall in the volume of government expenditure;

V. reduction in the volume of subsidies;

VI. reduction in fiscal deficit;

VII. reduction in public debt; and

VIII. disinvestment in the public sector.

Conclusion

The fiscal policy encompasses two separate but related decisions; public expenditures and the

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level and structure of taxes. It occupies the central place for maintaining full employment without inflationary forces in the economy. With its various instruments it influences the economic stability of an economy.

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