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FISCAL POLICY FRAMEWORK OF INDIA: AN ANALYTICAL STUDY

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ABSTRACT

Fiscal policy is an important component of the economic policy. Economic problems of different countries are different. The economic problems of a developing country are more flaming and sophisticated in nature then developed country. Poverty and unemployment are found in large scales in the developing country. The growth rate is also found in single digit. The growth of economy is a most important aspect for the country. For this reason, a suitable fiscal policy is needed. Fiscal policy tames the inflation and deflation both. The monetary policy's most important objective 'growth with stability' can also be achieved with the help of fiscal policy. Fiscal policy reduces consumption habits among the peoples and increases savings and investments. Thus, Fiscal policy creates capital formation for the development of the country.

Keywords: *Economy Policy, Developing Country, Poverty, Unemployment, Growth Rate, Monetary policy, Growth with Stability, Consumptions, Savings, Investments, Capital Formation, Inflation, Deflation.*

Introduction

Fiscal policy is the most important weapon in the hands of policy makers for economic development of the country. Now the states works as a welfare states and its role increased in the development after the World War II and doctrine of laissez faire has been left. In a welfare state, fiscal policy plays a vital role in the development of the economy.

Meaning and objectives of Fiscal Policy

Fiscal policy includes the activities of taxation, public expenditure and public debts which are used by the government for achieve of pre-determined objectives.

According to Arther Smitthies, "Fiscal Policy is a policy under which Government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on national income, production and employment." [1]

The main of the fiscal policy is 'growth with stability of the economy'. The other most important objective of the fiscal policy is to achievement of full employment. To quote Richard Musgrave, "The objectives of fiscal policy are higher level of employment, price stability, balance in foreign trade and increase in economic growth etc." [2] Here an increase in per capita output is called economic growth.

The following objectives of fiscal policy of our country may be determined for the development of our country:

- **Increase of high growth rate:** The primary objective of fiscal policy is affecting the investment level of the economy. According to U.Tun Wai, "Fiscal policy is the kingpin in determining the total level of investment." [3] It helps to increase in the investments. Fiscal policy determines the savings and investments level of the economy. Capital formation is also depends on the

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level of savings and investments. Narkse emphasised on the inducement to invest for capital formation which is fundamentally essential for economic development. [4] Fiscal policy helps in increase in capital formation and thus it ultimately increases the high growth rate. The productive investments and national income are being increased with help of appropriate policies of taxation, public expenditure and public debt. Fiscal policy breaks the vicious circle of poverty. [5]Fiscal Policy is being determined by the government. The Government expenditure affects directly Gross Domestic Product (GDP) while consumptions, investments and net inflows from the abroad affects indirectly as these increases aggregate demand.In Fig. 01 shows the effect of higher government expenditure of national income: [6]

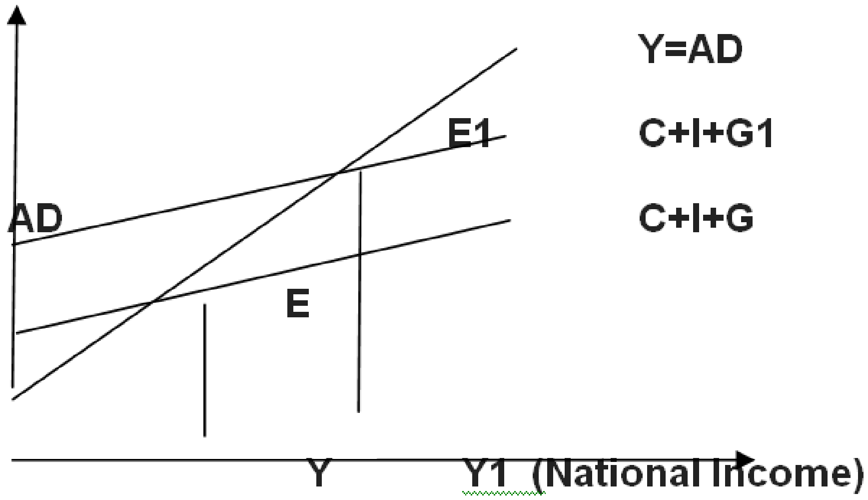


Figure 01 explained that initial level of the government expenditure is G and it increases to G1. The new equilibrium shifted to E1 from E and causes equilibrium income to increase from Y to Y1. Here National Income(Y) = Consumption (C) + Investment (I) + Government Expenditure (G).

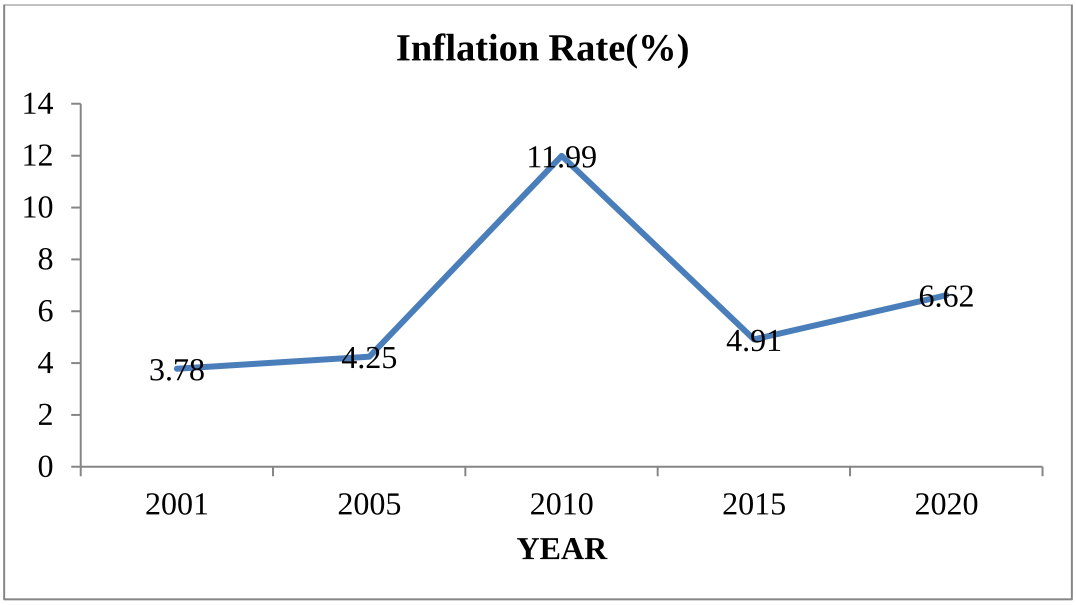
- **Increase in employment opportunity:** In the modern era, the main objective of the fiscal policy is to achieve full employment. Another aim of the fiscal policy is the aim of ensuring the full employment of the factors of production. Employment depends on 'effective demand' and there are two components of the effective demands namely one, expenditure on the consumption and secondly, expenditure on the investments. In other word, the effective demand is the sum of total amount of expenditure made on consumption and investments. Government can affects the quantity of effective demand by its budgets activities. The tool for achieving full employment, the government increases public expenditure and investments, repayments of public debts and reduces the rates of taxation. Thus, fiscal policy can brings more employment opportunities in the economy.
- **Growth with Price Stability:** When economy is in full employment conditions, then up swing do not bring the growth in real income but increases the inflation level and as a result, the prices of commodities are also increase. Therefore it is the prime objective of fiscal policy that up swing should not go beyond the full employment. Thus, fiscal policy is an important weapon of controlling the inflation. Inflation is in other words a 'invisible tax.' [7] Price stability means reasonable rate of inflation. Government can tame inflation with its budget policy, inflationary fiscal policy by increasing of taxation and public debts. [8]

Table 1: Retail Inflation Rate (2001-01 to 2019-20)

Year	Inflation Rate (in %)	Annual Change (in %)
2001	3.78	-0.23
2005	4.25	0.48
2010	11.99	1.11
2015	4.91	-1.76
2020	6,62	2.89

Table 01 indicates that retail inflation rates increased from 2001 to 2010 and then it reduced to 4.91 percent in 2015. It was rose to 6.62 percent in 2020.

Chart 1: Retail Inflation Rate (2001-01 to 2019-20)



It may be noted that by law, the central bank of India (RBI) is required to maintain inflation at a 4 percent level. However, the law provides a leeway of two Percentage points on either side of 4 percent in any particular month. This means retail inflation can be between 2 percent and 6 percent. [9]

- **To Stability Balance of Payments:** In general, the most of developing countries suffer from the problem of negative Balance of Payment in their foreign trade. Developing countries import more for the development purpose including machines, technology, capital and knowledge etc. The numbers of export items are countable on figures and most of them conventional like jute, rubber, tea, spices etc. The prices of the exports are very low and imports are high and this creates balance in negative. Governments can impose more import duties and reduce duties on exports items in its budget policy which is a main part of fiscal policy.
- **To reduce the Economic disparities:** A developing country faces two types of economic problems at the same time such as one is increase in national income and other is allocation national income in such manner that it reduces the disparities among citizens. Therefore, government takes such majors that provide allocation in lawful manner. In the words of J.M. Keynes 'If fiscal policy is used as a deliberate instrument for the more equal distribution of income, its effect in increasing the prosperity to consume is, of course, all the greater.' [10]The canon of equitable distribution is one of most canon of the public expenditure. It says that government expenditure should be spent so that backward sector and poorer get more share. [11] In the words Dalton, "Other things being equal one tax system is preferable to another, if it has stronger tendency to check inequality." [12] Thus, fiscal policy reduces the concentration of economics power in the hand of few.
- **To encourage socially optimal investment:** There are two time of overheads viz. social overheads (including education, public health, technology training etc.) and economic overheads (including transportation, communication, expansion of electricity, soil conservation etc.). These overheads are helping in increase of markets expansion, more production at low costs. [13] Positive externalities occur in the economy and public and private investments boosts up. Keynes suggested that during the period of depression the government should invest money in productive enterprises such as construction of dams, roads, bridges, hydroelectric projects, etc., so that unemployed persons might get employment and their purchasing power might increase, which would necessarily create more demand for commodities. Thus, pump-priming would remove the evil effects of depression and create employment. [14]

Impacts of the Fiscal Policy

The fiscal policy impacts individually as well as the domestic industry and exporters in particular. These impacts can be elaborated in the following points: [15]

- **Impacts on an individual:** The fiscal policy included an announcement on tax rates, government expenditure and public loans. The costs of commodities would immediately either increase or decrease. A reduction in tax rates would prompt individual to buy more commodities as their real income increases and vice versa. An increase in the tax rates will lead individuals ability to work slowly as they do not intake proper diet as their real income decreases. Their ability of savings is also badly affected. Dr. Dalton expressed that how taxation is effect the willingness to work and savings of a taxpayer. He explained the reaction of individuals depends on the elasticity of income demand. In the case inelastic income demand, an individual has to work more to get minimum income while in elastic demand he does not effort to increase his income and takes rests and in this situation his willingness to work and saving decreases. In his words, "If income demand is inelastic then increase the tax rate and if the income demand is elastic then decrease the tax rate." [16] Therefore, the government should collect taxes in such way that there should be balanced of burden on individual. Taxes on necessity goods should be at low rates. Progressive rate system of taxes should be adopted. An increase in interest rates of government bond, more individuals will buy or invest them and vice versa. Government decides tax rates and public expenditure to control inflation and deflation. If government invests or spends in big projects, more employment will be generated. Individuals will have more employment opportunities and this will lead them in prosperities.
- **Impacts on the domestic industry and exporters:** Exporters keenly look forward to the fiscal policy since the government always makes an announcement on export and import duties. If government reduces the import duty then imports will be increased and as result, the prices of the commodities decreases. The profit of the domestic industry will also affect. In the case export duty, low rate of export duty will increase more exports but it will increase inflation in the country. A lowering of these rates would mean lower borrowing costs for the exporter. Therefore, the government will have to choose balance action or mid-path while using fiscal policy. That is why domestic industry and exporters shows keen interest at the time budget announcement. If the costs of productions increases than profits of the firm will decreases in same manner. Thus, fiscal policy also effects on the firms for willingness to work, savings or investment incentives. To quote Dalton, "The best, system of taxation from the economic point of view is that which has the best, or the least bad, Economic effects." [17]

Instruments of Fiscal Policy

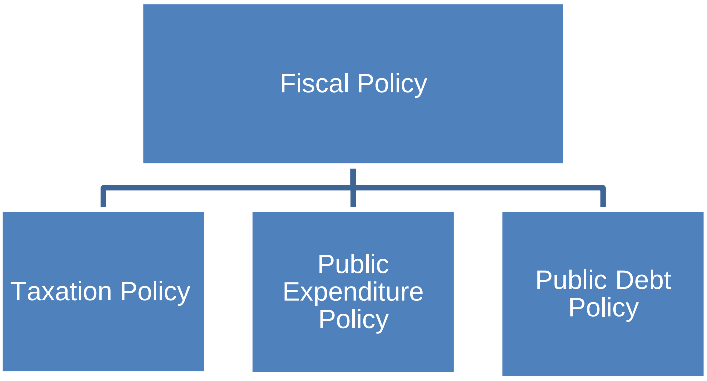


Fig. 2

The instruments of monetary policy are as follows:

- **Policy of Taxation:** Tax is most effective tools of the fiscal policy. Tax is a compulsory payment to the government. It controls inflation, consumption, motivates saving and investments, transfer of funds to the government, changes the structure of investments, reduces economic disparities, increases economic surpluses. [18]

The tax structure as present in India are broadly divided in two category viz. direct tax (including income tax, gift tax, wealth tax, capital tax, tax on profits etc.) and indirect tax (including value added tax, imports duty, export duty etc.). The main aim of a tax policy is control the tax evasion. An important dimension of the tax administration is to fight against the scourge of black money. [19] Taxation policy of the government should be production oriented. Progressive tax system should be adopted in a developing country. Revenue from the taxation are elaborated in the table 02:

Table 2: Tax Revenue

(During the period from 2000-01 to 2019-20)

(₹ in Crore)

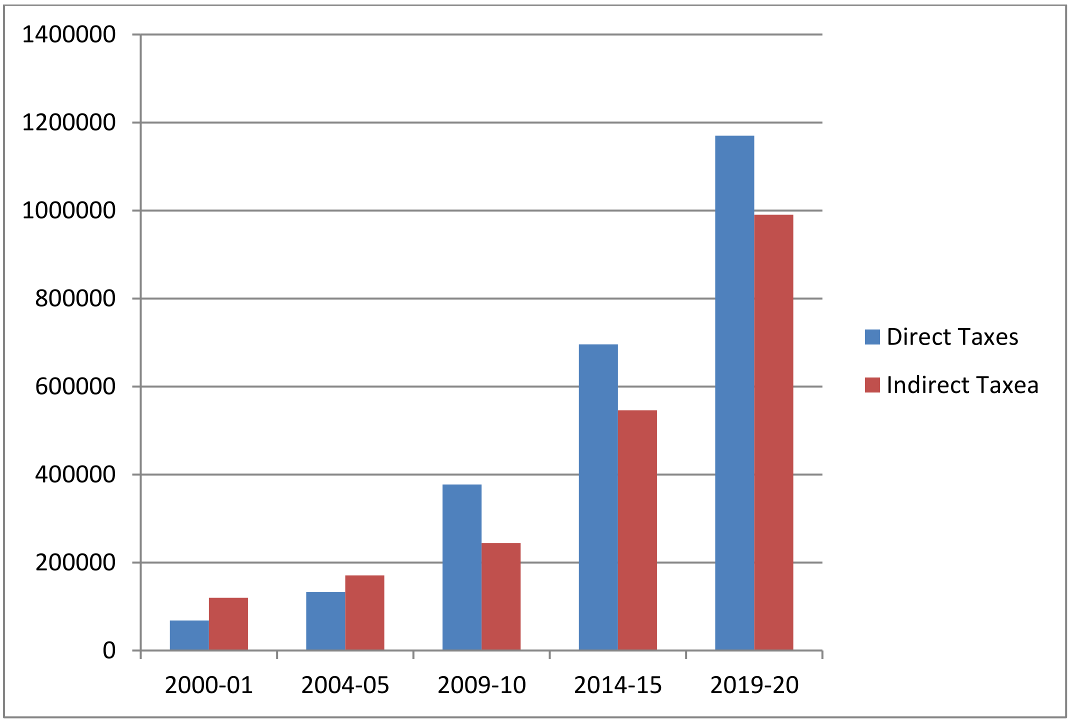
Financial Year	Direct Taxes	Indirect Taxes	Total Taxes	Direct Tax As % of Total Taxes
2000-01	68306	120040	188346	36,27
2004-05	132847	170546	303393	43.79
2009-10	377487	243881	621368	60.75
2014-15	695744	545680	1241424	56.04
2019-20	1170000	990633	2160633	54.15

Source: m.rbi.org.in

Table 02 shows that tax revenue of the government is continuously increasing since 2000-01. The amount of indirect taxes are more as comparatively to direct taxes up to 2004-05 and after that more collection of revenues comes from direct taxes. It means government gives more tax reliefs to the corporate sector. The share of direct tax to total taxes increased in 2009-10 to 60.75 percent from 36.27 percent (in 2000-01). However, it reduced to 54.15 percent in 2019-20. The collection of Direct tax increased more than 17 times (i.e. from ₹68306 to ₹1170000) while indirect tax increased only 8.25 times (i.e. from ₹120040 to ₹990633) and total tax increased 11.50 times approximately (i.e. from ₹188346 to ₹2160633) during the period. Thus, the direct tax is the major revenue source of the government as compare to indirect taxes. This is the biggest changes in the recent fiscal policies. This fact can also be seen in the chart 03.

Chart 3: Tax Revenue

(During the period from 2000-01 to 2019-20)



- **2) Policy of Public Expenditure:** Public expenditure plays an important role in the developing country. It is most important source of the economic development special in the mixed economy like India. Public expenditure increases growth rate of the economy, motivates private sector, built up of the economic or social infrastructures, development of the human capital, reduces of income and wealth disparities, providing more employment opportunities etc. [20] The major portion of government income should be expended on the development works. The government must run core industry in its hand.
- **3) Policy of Public Debt:** In a developing country, public loans play a specific role in the development of economy. Government needs large amount for development programmes which cannot be fulfilled only by taxation. Government could not collect large revenue from the taxpayer as there is a low income level the developing country while governments needs more revenues for the development programmes. High rate of taxation, had a bad impact on the taxpayer also. It reduces the willingness and capacity of working and also hampers the saving-investment pattern of the taxpayer. Therefore, the government takes the help from public loan policy. When government's revenue receipts are less than its expenditure it is called budget deficit. The budget deficit is met through the loans. In traditionally the government had seigniorage to print money and avoid loans. [20] But now the government prefers to take borrowings due to inflation. Loans are anti-inflationary and productive in nature. The purchasing power of the peoples transferred to the government. The amount of loans are huge and these are being used in import items like buying capital machine and technology assistance from the abroad.

Public debts are two types viz. internal debt and external debt. [22] In internal debt, dated securities, treasury bills, market loans, compensation and other bonds, securities small savings fund are included while in external debt, loans from the Asian Development Bank (ADB), International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD) or World Bank, International Development Association (IDA) and International Finance Corporation (IFC) are included. [23] Table 03 shows the details of internal and external debt of the government.

Table 3: Public Debt

(During the period from 2000-01 to 2019-20)

(₹ in Crore)

Year (ended March)	Internal Debt	External Debt	Total Debt	Internal Debt as % of Total Debt
2000-01	913062	199897	1112959	82.04
2004-05	1275971	191271	1467242	86,96
2009-10	2337047	249306	2586353	90.36
2014-15	4775900	194286	4970186	96.09
2019-20	8019959	856981	8605284	93.20

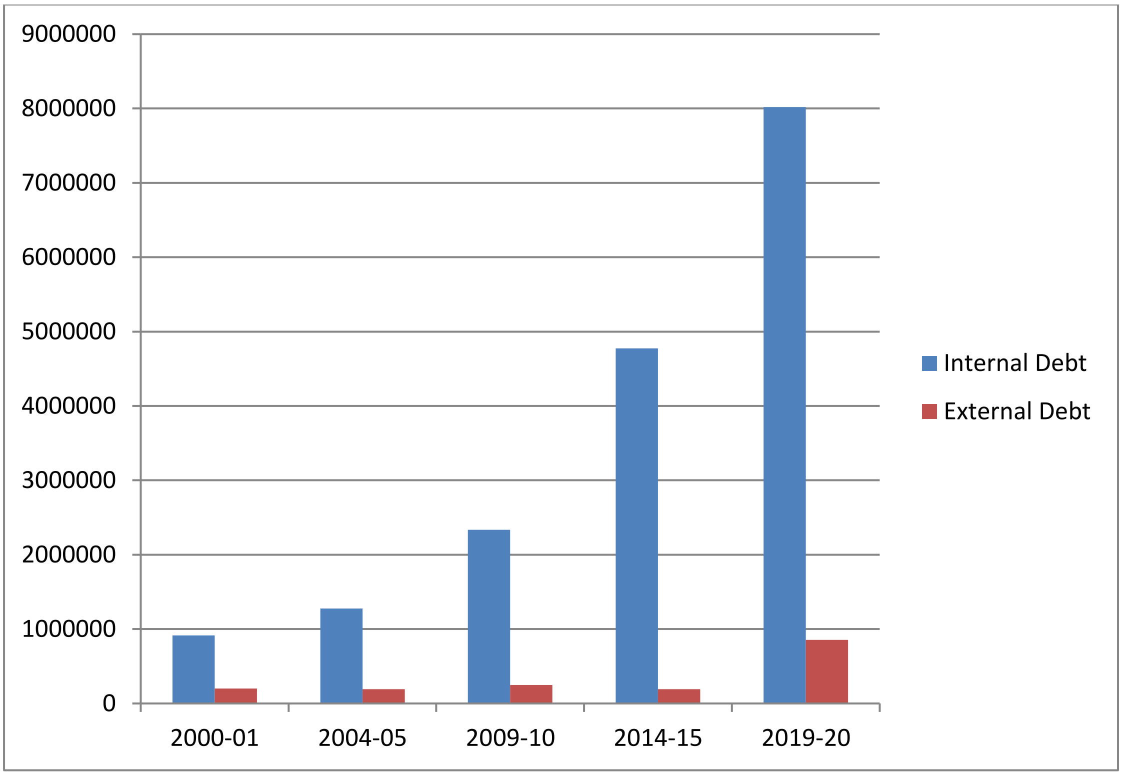
Source: dea.gov.in

Table 03 indicates that internal debt and external debt both have been increased during the period of 2000-01 to 2019-20. The share of internal debt to total debt increased in 2009-10 to 96.09 percent from 82.04 percent (in 2000-01). However, it reduced to 93.20 percent in 2019-20. The amount of internal debt were ₹913062 crore which increased to ₹8019959 during the period. During the same period, the external debt were ₹199897 in 2000-01 which increased to ₹856981 in 2019-20. The total debt increased to ₹8605284 from ₹1112959 during the period of 2000-01 to 2019-20. The amount collected under internal debt increased 8.78 times while external debt increased only 4,28 times and total tax increased 7.73 times during the period. Thus, the internal debt is the major debt source of the government as compare to external debt. This fact shows in the Chart 04.

Chart 4: Tax Revenue

(During the period from 2000-01 to 2019-20)

(₹ in Crore)



Fiscal Policy and Monetary Policy: An Interdependent Relationship

Fiscal and monetary policies are inter-dependent. Government uses both the policies to obtain certain economic objectives. However, precaution measures are to be taken carefully. It may happen that while curbing inflation, a tight fiscal policy's efforts will be ineffective in the case of a liberal monetary policy used at the same time. Fiscal policy is more effective in the developing countries while monetary policy is in the developed countries where appropriate financial system is available. Fiscal policy is now converting itself a 'event' and is using in public finance matter of the government.

Conclusion

The aims of a Fiscal policy are influence the economy, sustainable growth and reduce poverty in the country. Fiscal policy is created by the government of India. The government adopts 'loose' or 'tight' fiscal policy as per the requirement of the economy. In 'loose or expansionary fiscal policy' government increases aggregate demand through more spending and while in the case 'tight or contractionary fiscal policy' government reduces aggregate demand through less spending. There are three basics factors of fiscal policy viz. taxations, public expenditure and public debt. The government takes help of fiscal policy to remove the shortcomings of the monetary policy as money markets are not developed in the developing countries.

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