CHAPTER - III :: GOVERNMENT OF INDIA'S DEFICIT FINANCING -- A Review ::

1) INTRODUCTION:

The underdeveloped world has been facing a recovery problem. The governments of almost all the underdeveloped countries in Asia, Africa and Latin America are intended to accelerate their economic growth in order to improve the standards of living of their people. However, unlike developed countries they lack experienced, trained personnel as well as resources. They are also failing to collect sufficient revenues either because the tax structure is inadequate or because the tax laws are not properly enforced finance through borrowing but it is to be used as a last resort. The Government of India like the governments of other underdeveloped countries is anxious to accelerate development process in order to reach the stage of 'drive to maturity' within shortest possible time. For this, the government has chosen to resort to the method of deficit financing.

Against this background, we may now focus our attention on the extent and role of deficit financing in India's economic development. We can study it under two sections, the first, deals with the deficit financing before independence and second, deals with the deficit financing after independence.

2) DEFICIT FINANCING BEFORE INDEPENDENCE:

If we observe revenue and expenditure figures of the government during the days of East India Company we find a state of chronic deficit. In the course of 66 years from 1792 to 1858 it was under deficit due to increase in expenditure on account of war. During 1858 to 1914 military expenditure was again increased, so deficits mounted up. Every deficit was met by borrowing. Because of the First and the Second World Wars deficit again increased. The total deficit increased from Rs. 4 crores in 1939-40 to Rs.533.53 crores in 1945-46. This has been depicted in the Table.

Table -1 : Overall Deficit during War period.

Year		Overall Deficit Rs. in crores.
1939-40	...	4.00
1940-41	...	59.53
1941-42	...	206.69
1942-43	...	490.16
1943-44	...	605.11
1944-45	...	634.81
1945-46	...	533.53

Source: Reports on Currency & Finance, RBI.

Because of the increase in prices due to Second World War, the deficits increased from Rs.57.59 crores in 1946-47 to Rs.110.68 crores in 1947-48 then for two years it started to decline slowly to Rs.43.8 crores and there was a surplus of about Rs.12.44 crores in 1950-51. This has been shown in the Table No.2.

Table No.2: Overall Deficits during Post-war period.

Year		Overall deficits Rs. in crores
1946-47	...	- 57.59
1947-48	...	- 110.68
1948-49	...	- 81.67
1949-50	...	- 43.80
1950-51	...	+ 12.44

Source : Reports on Currency & Finance RBI.

3) DEFICIT FINANCING AFTER INDEPENDENCE:

After independence the continuous growth of population, inflation, defence expenditure caused mounting deficits. The Government of India initiated Five Year Plans for rapid economic development. So the public expenditure had continued to grow. In order to finance expenditure, demand for large resources arose. The plan outlays have been increasing continuously due to many reasons as mentioned earlier. The increase in plan outlays have been shown in the Table No.3. This table reveals that the total plan outlay during the First Five Year Plan was Rs.3,360 crores and it rose to Rs.6,831 crores during the Second Plan, to Rs322,366 crores in the Seventh Plan.

During the First Plan, the public sector outlay was Rs.1960 crores (i.e. 46.4%) and it had increased to Rs.8572 crores i.e. 60.6% of the total outlay during the Third Plan and then gradually declined to 47.8% in the Seventh Plan.

The Government of India is raising resources through various sources. They are divided as domestic sources and external sources. The domestic sources include current revenues, contribution of railways, surplus of public enterprises, additional resources, mobilisation i.e. taxation and borrowing which include borrowing from public, small savings, deposits, provident fund and deficit financing. Table No.4 reveals that domestic resources accounted for 90.4% of total resources during the First Five Year Plan and it had declined to 77.5% to 64% in Second and Third Plan

Table No.3 : Plan Outlays investments of Public and Private Sector. (Rs. in Crores)

	Ist Plan	IInd Plan	IIIrd Plan	IVth Plan	Vth Plan	VIth Plan	VIIth Plan	VIIIth Plan
1. Public Sector Outlay	1960	4672	8572	15779	40097	97500	180000	650000
2. Public Sector Investment	1560	8231	6300	13655	36703	84000	154218	-
3. Private Sector Outlay	1800	3100	4100	8980	27048	74710	168148	-
4. Total Outlay	3360	6810	10400	22635	-	158710	322366	
5. 2 as % of 4	46.4	54.6	60.6	60.3	57.6	52.9	47.8	
6. 3 as % of 4	53.6	45.4	39.4	39.7	42.4	47.1	52.2	

Source : Indian Economic Statistic, Public Finance, 1983.

respectively, then it increased to 92.3% by Sixth Plan and come down to 90% in Seventh Plan.

Table No.4 : Pattern of Financing Plans.
(As % of total)

Plans	Total Domestic Resources (Rs.in Crs.)	In %	Total External Resources (Rs.in Crs)	In %
I	1771	90.4	189	9.6
II	3623	77.5	1049	22.5
III	6154	64.0	2423	28.5
IV	14073	87.1	2087	12.9
V	35503	87.2	5209	12.8
VI	102092	92.3	8529	7.7
VII	162000	90.0	18000	10.0

Source : India Observer Statistical Handbook 1991 by B.N. Uniyal.

External resources as a percentage of total resources had increased from 9.6% to 28.5% during the First to the Third Plan and declined to 7.7% by the Sixth Plan and increased to 30% at the end of Seventh Plan.

Taxation

Taxation is the biggest source of public revenue in India and it is also the main domestic source of financing development plans. But all the tax revenue collected by the public authorities does not go to finance development plans only. Along with this government have to spend a lot on non-development items also. The revenue remaining after spending on non-development items is used to finance development which is called the balance from current revenue.

The Government imposes taxes in two types such as direct taxes and indirect taxes. The direct taxes comprises income tax, wealth tax, corporate tax, profit tax etc. The indirect tax comprises taxes on all commodities. The revenue collected from these types are shown in the Table No.5. The revenue collected from the direct taxes was 2.47% of the total resources in 1950-51 it has decreased to 2.41% in 1980-81 and to 2.38% in 1985-86.

The revenue collected from indirect taxes has increased from 4.23% of total resources in 1950-51 to 12.21% in 1980-81 to 14.62% in 1988-89. This tells us that in the India's tax structure indirect taxes plays a very important role. The total tax receipts as a

Table No. 5: Total Tax Revenue (All India) in percentage.

Year	Direct Tax	Indirect Tax	Total Tax Receipts
1950-51	2.47	4.23	6.69
1960-61	2.48	5.85	8.33
1970-71	2.44	8.67	11.01
1980-81	2.41	12.21	14.61
1985-86	2.38	14.10	16.48
1988-89	2.49	14.62	17.11

Source: Indian Economic Statistics, Public Finance, Ministry of Finance, 1990.

percentage of total resources have increased from 6.69% in 1950-51 to 14.61% in 1980-81 to 17.11% in 1988-89. This tells us that the tax system in India is inadequate.

In order to increase finance government has increased dependence on indirect taxes. But the indirect taxes largely imposed on consumers through shifting.

The balance from current revenue is not enough for financing the ever increasing expenditure and additional taxation has to be imposed for collecting substantial resource in two ways (a) by increasing the rates or reducing rebates, of taxes and (b) by imposing new taxes and duties.

In order to meet increasing expenditure both the Central and State Governments have used their taxing powers extensively and intensively. Table No.6 depicts the growth of total tax revenue. The total tax

Table No.6 : Growth of Tax Receipts
(Rs.in crores)

Year	Total Tax Receipts	As % of National Income
1950	627	7.1
1955	768	8.3
1960	1350	10.2
1965	2922	14.2
1968	3759	13.1
1973	7389	14.7
1978	15528	19.1
1979	17683	20.0
1980	19844	18.7
1981	24142	19.9
1982(RE)	27484	21.9
1988(RE)	32650	-
1990(RE)	38390	-

Source : India Economic Statistics, Public Finance, Govt. of India and Budgets.

revenue of the centre and states increased from Rs.627 crores in 1950-51 to Rs.15,528 crores in 1978-79 i.e. an increase of less than 25 times and to Rs.38,390 crores in 1990-91.

As stated above the government has to imposed additional taxation to a great extent for financing the increasing expenditure. As given in the following table tax revenue by way of additional taxation increased from Rs.255 crores in the First Plan to Rs.7056 crores in the Fifth Plan.

Table No.7 : Additional Taxation in Plans. (Rs.in crores)

Plan	Targets	Actuals
I	-	255
II	450	1052
III	1710	2892
IV	3198	4280
V	6850	7056
VI	8250	13133

Source : Repoorts on Currency & Finance, RBI.

This table also reveals that the additional taxation targetedis less than actuals which implies imposition of additional taxation at higher rate. In

Table No.5 tax resources as percentage of national income was very low i.e. 7.1% in 1950-51, however, it had increased to 21.9% in 1982-83 but it is also insufficient. This is because of tax evasion which is mainly due to high tax rates. High rates of taxes not only lead to tax evasion but it also adversely affects savings and investment. Though the rates of savings and investment have increased, these rates almost stagnated in few years especially after 1978-79. This implies that there is a strong need to reduce tax rates.

In order to meet the increasing expenditure both the Central and State Governments have used their taxing powers extensively and intensively and the total tax receipts have increased. However, the deficits in the Government budgets have continued to rise as shown in Table No.8.

The table shows that on 'revenue account', the total receipts from all sources have increased from Rs.3342 crores in 1970-71 to Rs.60763 crores followed by increase in expenditure from Rs.3179 crores to Rs.73795 crores in same period. In 1970-71 there was a surplus on revenue account, after 1975 there have been increases in deficits on revenue account from Rs.1715 crores in 1980-81 to Rs.13032 crores in 1990-91.

Table No.8 : Budgetary Position of the Government of India

Year	Revenue Account			Capital Account			Overall Deficit
	Receipts	Expenditure	Surplus	Receipts	Disbursement	Surplus	
1970-71	3342	3179	+ 163	2046	2494	- 448	- 285
1975-76	8075	7188	+ 887	4149	5402	-1253	- 366
1980-81	12829	14544	- 1715	8771	9633	- 862	-2577
1983-84	20493	22890	- 2397	15861	14881	+ 980	-1417
1984-85	24384	24881	- 3497	17768	18016	- 248	-3745
1985-86	29207	34772	- 5565	16763	16135	+ 628	-4937
1986-87	24768	42544	- 7776	18529	19014	- 485	-8261
1987-88	38992	48129	- 9137	22026	1807	+3321	-5816
1988-89	45740	56255	-10515	25673	20800	+4873	-5642
1989-90(RE)	54616	67052	-12436	23692	23006	+ 686	-11750
1990-91(BE)	60763	73795	-13032	29391	23565	+ 582	-7206

The overall deficits in the budgets of the Government of India have been increasing continously. The overall deficit has increased from Rs.255 crores in 1970-71 to Rs.4937 crores in 1985-86 to Rs.11750 crores by 1989-90 which has been reduced to Rs.7206 crores in 1990-91 which is still very high.

MEASUREMENT OF DEFICIT FINANCING IN INDIA :

The accurate form in which the concept of deficit financing is given the form of figures in India may be spelt out briefly in the following manner.

Firstly, in measuring the total deficit financing one has to add together the deficits both on account of the Central Government as also of the State Governments in order to get the total amount of deficit financing adopted for the economy.

Secondly, in measuring the budgetary deficit we should note the difference in the ways of the two governments at two different levels. In case of the Union Government the budgetory deficit for the year (from 1st April to 31st March) is measured by the sum of the changes in the following two items.

a) net increase in the outstanding treasury bills and (b) withdrawals from cash balances.

In case of the State Governments it is measured with reference to the following four items.

a) net increase in the REBI's credit in the form of ways and means advances and overdrafts.

b) decline in cash balances.

c) net sales of securities held by the State Govts. in their cash balance net accounts and

d) enhancement of securities held in the revenue reserve funds.

These above mentioned two types of calculations in respect of the Central Government and the State Governments lead to the following two methods of measuring the budgetory deficitof the Central and State governments.

(i) Central Govt.Deficit	=	Net increase in the holding of treasury bills and changes in cash balances.
(ii) State Govt.Deficit	=	Net Credit under ways and means advances and changes in their cash balances.

Therefore,

Total Deficit of the Economy	=	Central Govt Deficit + State Govts. Deficit.

TYPES OF DEFICIT FINANCING

The deficits of the government can be measured in various types as given below :

1) Monetised Deficits - Monetised deficits means increase in net Reserve Bank of India credit to the Central Government.

2) Budgetary Deficits - The budgetary deficit means the revenue deficit plus net capital disbursement minus borrowings.

3) Revenue Deficits - The revenue deficit means the difference between revenue expenditure and revenue receipts.

4) Fiscal Deficit - Fiscal deficit means revenue expenditure plus net capital disbursement minus revenue receipts. It can also be said as revenue deficit plus net capital disbursement. In other words, fiscal deficit means, budgetary deficits plus borrowings.

The increase in deficit in Central Budget can be shown in the Table No.9 under various forms of deficits.

Revenue deficit of the union budget rose from 0.6% to 3.4% during 1980-81 to 1990-91. The budgetary deficits in 1980-81 was about 1.8%. It has reduced to 0.6% by 1984-85. It again increased to 2.0% in 1985-86. This has abated to 1.1% in 1990-91. Monetised

Table No.9 : Various measures of deficit financing in Central Budget (in percentages)

Year	Revenue deficit	Budgetary deficit	Monetised deficit	Gross Fiscal deficit	Primary deficit
1980-81	0.6	1.8	2.6	6.2	4.2
1981-82	0.1	0.9	2.0	5.4	3.4
1982-83	0.7	0.9	1.9	6.0	3.8
1983-84	1.2	0.7	1.9	6.3	4.0
1984-85	1.8	0.6	2.6	7.5	4.9
1985-86	2.2	2.0	2.4	8.3	5.4
1986-87	2.8	1.8	2.4	9.0	5.8
1987-88	2.7	1.7	2.0	8.1	4.7
1988-89	2.7	1.4	1.6	7.8	4.2
1989-90	2.7	1.4	3.1	8.0	4.0
1990-91 (BE)	2.5	1.4	1.7	7.1	3.1
1990-91 (RE)	3.4	1.1	3.0	8.4	4.1
1991-92 (BE)	2.3	1.3	1.3	6.3	1.7

Source : Economic Survey 1989-90 & 1990-91, The Government of India Budget at Glance, 1991-92

deficit was 2.6% in 1980-81. It was decreased to 1.9% in 1983-84 and rose to 2.6% again in 1984-85. Then it continued to decline upto 1.6% by 1988-89. Further it rose to 3.0% in 1990-91. The gross fiscal deficit was highest i.e. 9.0% in 1986-87. It was also fluctuating. Primary deficit was more in 1986-87 i.e. about 5.8% and then it started decline. In the year 1991-92 (BE). The primary deficit was 1.7%.

INTERNAL DEBT (Domestic Borrowing)

It was another main source of financing economic development in India. It had been an age old source of public revenue. This includes market borrowings, small savings, provident funds, term loans from financial institutions. In the budgetory language we can call the domestic borrowing as internal public debt. Deficit financing is also a part of domestic borrowings.

Market borrowings include government borrowings (bonds and securities) from the public, state enterprises like L.I.C. and nationalised commercial banks etc. Capital market in India is not developed so bonds and securities have not been popular.

Savings as a component of domestic borrowings are of three types such as house-hold savings, corporate savings and government savings. Small savings flow from households in the form of post office deposits, all sorts of national saving certificates like Indira Vikas Patra, Development Bonds and Provident Fund. The saving capacity of the people in India is very low. The table No.10 shows the growth of internal sources.

Table No.10: Public Debt and Other Liabilities of the Government of India (Rs. in Crores)

Year	Internal Debt		Market Loans	Small Savings	Provident Fund
1970	7663		4442	2209	-
1975	12371		6434	3552	-
1985	58537		30360	17157	-
1986	71039	(27.1)	35240.5	21449	-
1987	86312	(29.6)	40832.0	24725	-
1988	98646	(29.7)	46695.4	23223.2	28358
1989	114498	(29.0)	55114.7	25745.8	33833
1990	133193.3	(30.1)	62519.7	28342.7	41791.3
1991(RE)	151352.3	(29.2)	70520.0	31830.9	49071.3
1992(BE)	171589.0		78019.8	35112.4	56281.3

Note : Figures in paranthesis indicate the percentage.

Source : Report on Currency and Finance 1975-76, 1976-77, 1989-90, 1990-91 Vol. I & II.

The total internal debt has increased from Rs.7663 crores in 1970 to Rs.71039 crores in 1986 to Rs.171589 crores in 1992. Internal debt as a percentage of total resources has increased from 27.1% in 1986 to 30%.1% in 1990.

The main and largest component of Domestic Borrowings (Internal debt) is market loans (Market borrowing). It has increased from Rs.4442 crores in 1970 to Rs.35240 crores in 1986 to Rs.78019 crores in 1992.

Small Savings have increased from Rs.2209 crores to Rs.5112.4 crores during 1970 to 1992.

Table No.11 shows small savings as a percentage of domestic resources.

Table No. 11 : Small Savings as a Percentage of Domestic Resources.

Year		Small Savings as a percentage of domestic resources.
1980-81	...	5.8%
1981-82	...	5.9%
1982-83	...	6.2%
1983-84	...	6.5%
1984-85	...	7.4%
1985-86	...	8.2%
1986-87	...	8.5%
1987-88	...	8.5%
1988-89	...	8.6%
1989-90	...	9.3%
1990-91	...	9.4%

Source: RBI Bulletin 1992.

Small saving as a percentage of total domestic resources has increased contineously from 5.8% in 1980-81 to 8.2% in 1985-86 to 9.4% in 1990-91. But the increase in small savings are very low as compared to increase in expenditure. This is because of difficulty in collection and organisation due to poverty and rising prices and increasing tax burden.

Although the domestic borrowing has increased in order to finance expenditure the burden of such borrowing (internal debt) is also increased. Table No.12 shows the interest payments on internal public debt which increased from Rs.78 crores in 1950-51 to Rs.6584 crores in 1983-84. The interest payments as a percentage of total expenditure have increased from 8.5% in 1950-51 to 11.6% in 1983-84.

All this explains that there is not much scope for raising additional resources from this source. The failure of domestic resources to meet needs of development plan necessitates external assistance.

External assistance is a vital input for economic growth at least on two important counts. First it enables a developing country step-up its rate of investment beyond the saving capabilities. Secondly, it makes possible for a country to import more than its current ability to pay in terms of exports. External assistance is thus a means to facilitate and accelerate the process of growth by allowing the aid receiving country to import machinery and equipment alongwith the technology.

Table No.12 : Interest Payments on Internal Public Debt. (Rs. in crores)

Year	Interest Payments Rs.	As % of Total Expenditure
1950-51	78	8.5%
1955-56	126	8.6%
1960-61	255	9.4%
1965-66	492	8.8%
1973-74	1230	10.3%
1978-79	2565	9.8%
1979-80	2929	9.9%
1980-81	3614	10.1%
1981-82	4392	10.7%
1982-83	5361	11.1%
1983-84	6584	11.6%
1985-86	71039	-
1990-91	151037	-

Source : Indian Economic Statistics, Public Finance, GOI, Ministry of Finance Sept, 1975 & December, 1983,1984.

Though it facilitates economic development of the country it is not always desirable, because it lead to transfer of resources to foreign countries and burden of interest payments. However, the external assistance from international agencies like IMF may have the burden lower than the other sources likeforeign governments, foreign private companies. But the loan from the IMF is not available upto the requirements.

The burden of foreign public debt is given in Table No.13.

The outstanding foreign public debt has increased from Rs.32 crores in 1950-51 to Rs.54100 crores in 1989-90. Interest payment on foreign debt was Rs. 2 crores in 1950-51 and it had gone up to Rs.1618 crores in 1989-90. The interest payment as a percentage of outstanding debt was high in 1950-51 and it has declined to 1.8% in 1982-83 and again increased to 3% by 1989-90.

If we observe the bad effects of sources of financing deficits like taxation and borrowing it can automatically be justifiable that deficit financing and that is important source for economic development in India. But in adopting these different views on

Table No.13 : Burden of Foreign Public Debt
(Rs. in crores)

Year	Outstanding Foreign Debt	Interest on Foreign Debt	Interest as a % of outstanding Debt
1950-51	32	2	5.0
1965-66	3152	86	2.7
1975-76	10384	184	1.8
1980-81	12479	252	1.9
1981-82	15445	276	1.8
1982-83	17577	320	1.8
1983-84	20214	369	2.0
1985-86	24004	470	2.0
1986-87	26638	544	2.4
1987-88	32312	772	2.7
1988-89	46838	1244	2.7
1989-90	54100	1618	3.0

Source : Indian Economic Statistics, Public Finance Dec. 1990, Ministry of Finance (India Economic Information Year Book 1991-92,p.261.

deficit financing, the Planning Commission stated that deficit financing result in increasing prices and high cost of living. It regarded that it should be adopted as a last resort and upto a limited extent. The Taxation Enquiry Commission emphasised the use of taxation and borrowing for financing the plans and advocated the minimum use of deficit financing. It favoured the use of deficit financing but it states that the rate of deficit financing must be within limit.

Dr. B.K. Shenoy has been a vehement critic of deficit financing since the beginning of planning. He was even against the very mild dose of deficit financing because of three reasons. Firstly, it had misdirected and diverted natural resources to smuggling of gold. Secondly, it puts stress on citizens earning. Thirdly, it leads to lowering moral standard of society.

Another well known economist Dr.V.K.R.V. Rao was in favour of the use of deficit financing but he wanted that safe limit of the deficit financing should not be crossed because it would then lead to hyper inflation and no growth.

Dr. R.N. Bhargava thinks that deficit financing in the Indian context has its dangers. Yet it is a useful technique if handled with care and imagination.

The IMF mission visited India in 1953 and presented its reports on "Economic Development with stability" to the Government of India. In this report it is stated that to develop India, more money would be needed for increasing production. The experts made rough estimates of non-inflationary deficit financing in the First Five Year Plan and found that Rs.100 crores per year would be quite safe. Totally they were in favour of adopting deficit financing.

In spite of all these views in favour and against the use of deficit financing and low targets of deficit financing set by Planning Commission for the Third and the Later Plans, its use was not stopped knowing all its evils.

Table No.14 shows that, except for the Second Plan the actual deficit financing has been much more

Table No.14 : Deficit Financing During Plans.
(Rs. in Crores)

Plan	Target	Actual
I	290	333
II	1200	954
III	555	1133
IV	850	2060
V	1354	3560(RE)
VI	5000	12835(RE)
VII	14000	-
VIII 1980-81 to 1984-85	7520	15670

than the targeted one in all the plans.

All these go to show that however, bad it may be, we cannot do without deficit financing at least for sometime in future. It is a sort of necessary evil attached to our development efforts. Instead of suggesting that government must do away with deficit financing as has been a hue and cry since long we must concentrate on looking for ways and means of lessening its harmful effects, making it more useful for economic development and raising its upper limit.

In Table No.15 we can see the yearly deficit financing, total money supply, variations in money supply, Index of wholesale prices and change in price level from 1951-52 to 1968-69. From this table it is found that money supply, deficit financing and wholesaleprices did not show any regular trend. That is no deficit financing in 1951-52 and Rs.36 crores in 1952-53. It increased to Rs.430 crores in 1957-58, it had again declined to 136 crores in 1958-59, again it was large in 1965-66. Money supply had increased continuously from Rs.1804 crores to Rs.5779 crores during 1951-52 to 1968-69 but variations in money supply is not same in all years. It was less in 1957-58 i.e. Rs.72 crores and it increased to Rs.449 crores

Table No.15 : Deficit Financing, Money Supply and Prices during 1950-51 to 1968-69.

ear	Deficit Financing	Total Money Supply	Variations in Money Supply	% Variations in Money Supply	Index Number of Wholesale Pric (1952-53= 100)
IRST FIVE YEAR PLAN					
951-52	- 15	1804	- 175	- 8.8	114.2
952-53	36	1765	- 39	- 2.1	100.0
953-54	- 18	1794	29	1.6	104.6
954-55	57	1921	127	7.0	97.04
955-56	200	2220	299	15.5	92.5
verall 5 years				29.2	
ECOND FIVE YEAR PLAN					
956-57	207	2345	125	5.6	105.3
957-58	430	2417	72	3.0	108.4
958-59	136	2530	113	4.6	112.9
959-60	165	2725	195	7.7	117.1
960-61	149	2869	144	5.2	124.8
				(57.8%)	(1961-62 = 100)
HIRD FIVE YEAR PLAN					
961-62	181	3046	177	6.1	100.0
962-63	180	3310	264	8.6	103.8
963-64	212	3752	442	13.3	110.2
964-65	162	4080	328	8.7	122.3
965-66	398	4528	449	11.0	131.6
				(27.5%)	
NNUAL PLANS					
966-67	189	4950	421	9.3	149.9
967-68	224	5350	400	8.0	167.3
968-69	263	5779	429	8.0	165.4

in 1965-66. The percentage variations in money supply was highest in 1955-56 i.e. 15.5%.

IMPACT OF DEFICIT FINANCING ON MONEY SUPPLY AND PRICE LEVEL

It is common to say that increasing deficit financing leads to increasing money supply and price level. But if we observe trends of deficit financing and money supply it will be clear that deficit financing did not have effects on money supply. That is 1952-53 deficit financing was Rs.39 crores while money supply decreased by Rs.39 crores i.e. from Rs.1804 crores to 1765 crores and there was no deficit financing in 1953-54 but money supply increased by Rs.29 crores. Later on an increase in deficit financing led to an increase in money supply but not in proportionally. Deficit financing in 1957-58 was larger i.e. Rs.430 crores but increases in money in that year was very less i.e. Rs.72 crores. Whereas deficit financing in 1968-69 was less (i.e. Rs.263 crores) than previously but the increase in money supply was more i.e. Rs.429 crores, from this it is clear that deficit financing and money supply are not directly related.

With surplus of Rs.15 crores in 1951-52, the inflation rate moved up by 2.1% while with an increase in deficit financing from Rs.36 crores in 1952-53 to Rs.57 crores in 1954-55 to Rs.200 crores in 1955-56, inflation rate had decreased by 12.4%, 6.9% and 5.0% in respective years. Increase in deficit financing had no inflationary impact in the First Plan.

In 1956-57 the inflation rate rose by 13.8% with deficit financing of Rs.297 crores while inflation rate had declined to 2.9% with high dose of deficit financing in 1957-58 i.e. Rs.430 crores. Thereafter, deficit financing declined but inflation rate had continued to increase to 6.5%. Again by 1966-67 it had hiked to 13.9% with deficit financing of Rs.189 crores and declined to - 1.1% by 1968-69. With deficit financing of Rs.263 crores. All these reveal that deficit financing did not lead to any price rise.

In spite of deficit financing of Rs.36 crores price level had declined by 12.4% in 1952-53, it was mainly due to favourable weather conditions which lead to an increase in supply of agricultural goods and raw materials. In 1953-54 price level rose due to anti-recessionary measures like removal of restrictions on imports and exports. 1955-56 recovery was short lived, price level fell due to increase in agricultural production. Therefore, Government of India adopted Price Support Policy in 1955.

In 1956-57 only with Rs.297 crores of deficit financing price level had increased to 13.8% due to increase in investment and decrease in agricultural production. Government had tried to increase production, increase imports and distribute through fair price shops to reduce prices which resulted decrease in price level to 2.9%. Again 1958-59 price level rose by 4.1% due to sharp decrease inagricultural production and industrial production due to lack of raw materials. In 1959-60 price level decreased to 3.7% due to fiscal and monetary measures. Second Plan was considered as warning of inflationary pressures.

In Third Plan except 1961-62 remaining four years from 1962-63 to 1965-66 money supply increased more than deficit financing. Increase in deficit financing had no any bad effects on price. In 1962-63 inflationary rate rose by 3.8% due to bank credit and Chinese aggression in 1962-63. During annual plans in 1966-67 inflationary rate rose to 13.9% because of war with Pakistan in 1965-66 whereas in 1968-69 it had declined to 1.1% with deficit financing of Rs.263 crores. This reveals that deficit financing had no inflationary impact.

Table No.16 reveals the impact of deficit financing on money supply and p;rice level from 1969-70 to 1989-90.

Table No. 16 : Deficit Financing, Money Supply and Prices during 1969-70 to 1989-90

Years	Deficit Financing	Total Money Supply	Variations in Money supply	3 as % 2	Index Number of Whole Sale price (1061-62=100)	% Change in price level
1	1	2	3	4	5	6
FOURTH FIVE YEAR PLAN						
1969-70	58	6387	608	10.5	171.6	3.7
1970-71	359	7140	753	11.7	181.1	5.5
1971-72	710	8138	998	13.9	188.4	4.0
1972-73	848	4413	1275	15.6	207.0	9.8
1973-74	775	10848	1435	15.2	254.2	22.8
FIFTH FIVE YEAR PLAN						
1974-75	654	11907	1059	10.6	175	24.6
1975-76	-206	13172	1265	10.6	173	-1.0
1976-77	340	15650	2478	18.8	177	2.0
1977-78	-238	14388	-1262	- 8.0	186	5.2
1978-79	1602	17229	2841	19.7	186	0.0
SIXTH FIVE YEAR PLAN						
1980-81	3451	23424	3424	17.1	257.3	1[illegible].2
1981-82	2519	24937	1513	6.4	281.3	9.3
1982-83	2350	28535	3598	14.4	288.7	2.6
1983-84	2135	33398	4863	17.0	316.1	9.4
1984-85	5105	39915	6517	19.[illegible]	346.3	9.6
SEVENTH FIVE YEAR PLAN						
1985-86	3439	44095	41[illegible]	10.5	359.3	5.7
1986-87	9283	51515	7420	16.8	378.2	5.3
1987-88	6247	56[illegible]26	5311	10.3	41[illegible].3	6.1
1988-89	7940	66607	9781	7.2	224.7 ?	7.9
1989-90	7[illegible]37	81619	15092	5.1	224.9	11.7

During 1969-70 deficit financing undertaken was kept down to Rs.58 crores as against deficit financing of Rs.263 crores in 1968-69. This was because NNP had increased by 20.5% since 1967-68 and revenue nearly sufficient for meeting expenditure.

There was sharp increase in amount of deficit financing in 1970-71 to Rs.359 crores due to abatement in industrialoutput which affected collection of revenue. In 1971-72 the amount of deficit financing was the highest i.e. Rs.710 crores as compared to previous year. In the last two years of the Fourth Plan natural calamities and drought conditions raised deficit financing to Rs.848 crores in 1972-73. Increase in deficit financing during first four years of the Plan resulted in increase in money supply but in the last year i.e. in 1973-74 deficit financing decreased from Rs.848 crores to Rs.775 crores but the money supply increased to Rs.10848 crores. Inflation rate in 1969-70 increased by 3.7% due to slow growth of agricultural output and it had continued to rise to 22.8% by 1973-74 because of drought.

During the Fifth Plan the inflation rate again rose by 24.6% really a high rate of inflation in 1974-75 with Rs.654 crores deficit financing. By considering the impact of deficit financing on price rise in the previous year, the Government had left deficit financing in 1975-76. There was no deficit financing during this year also due to surplus, the inflation rate came down to 1.0%. The decrease in inflation rate was not mainly due to decrease in deficit financing but because of increase in agricultural and industrial production by 7%. It was proved to be a record year for growth with stability. This resulted in a favourable condition for resortingdeficit financing in 1976-77. The total deficit financing during this year was Rs.340 crores and the inflation rate rose by 2%. This was not due to deficit financing but due to expansion of credit through commercial banks.

There was surplus in 1977-78 of about Rs.238 crores, hence there was no deficit financing. During this year there was also a decrease in money supply by 1262 crores but the inflation rate rose by 5.2%. In 1978-79 despite large deficit financing and increase in money supply by 20% there was stability in prices i.e. index number of wholesale prices remained constant at 186. This was because of record of agricultural production and restrictive monetary and credit policy.

The drought conditions and crop failures in 1979-80 led to an increase in prices to 18.2% in 1980-81. Therefore, control of inflation had been a major objective of the government policy by augmenting supply through higher production, better capacity utilisation, import of essential commodities, curbing activities of the hoarders, speculators and blackmarketers. Apart from all these controls economic situation showed improvement during 1981-82 i.e. agricultural production had increased dur to bumper crops of 1980-81 which resulted in decrease in inflationrate from 18.2%, 1980-81 to 9.3% in 1981-82 with deficit financing about Rs.2519 crores.

In 1982-83 there was severe drought which lead to decrease in production. Inspite of decrease in production. In spite of decrease in production the inflation rate rose only by 2.6% during 1982-83. The inflation rate had increased again to 9.4% in 1983-84 and 9.6% in 1984-85 due to stagnant production with Rs.5105 crores deficit financing. Control of monetary expansion and credit control led to low inflation rate in 1985-86 i.e.5.7%, 5.3% in 1986-87 and 6% in 1987-88.

The budget aims to control prices through restraint on the money supply growth rate. Money is, however, one of many factors that influence the price level in India. The differential growth of agricultural and non-agricultural output, administered price, procurement price, public distribution of foodgrains, wage rate, import price and exchange rate are other major determinants of inflation in India. Table No.17 shows that there was no excessive growth of money supply (either M1 or M3), in 1990-91 infact money supply growth in rate in 1990-91 was lower than that in last few years. And yet inflation rate in 1990-91 was higher than in the past several years. The main reason for this is the steep rise in the procurement price and import-price and decrease in exchange rate by 30% in 1991-92.

The procurement prices have hiked for the 1991-92 Khariff season by 5 to 15% and the administered prices for petroleum products increased by 20%.

The Kumarswamy Theorem of Inflation rates that there must be a synchronised correlation between the growth of GNP and growth of money supply. "The growth of money supply must be twice the growth of real GNP to maintain price stability and the rational size of inflationary gap is determined by establishing a synchronised correletion between the growth of real GNP and money supply."

Table No.17 : Money Supply, output and Price (in Percentage)

Year	GNP	Foodgrains	Money Supply		All Commodities	Agl.Commodities	Mfg.
			M3	M1			
1982-83	2.6	- 2.9	14.3	11.1	4.9	7.3	3.5
1983-84	7.9	- 17.9	17.4	14.6	7.5	13.1	6.1
1984-85	3.8	- 4.5	18.2	18.3	6.5	6.4	7.0
1985-86	4.1	3.4	17.1	13.9	4.4	-0.1	5.9
1986-87	3.6	- 4.7	17.5	14.7	5.8	10.6	3.9
1987-88	4.2	- 2.1	17.3	15.0	8.3	13.6	7.2
1988-89	10.6	21.0	17.1	14.5	7.5	5.6	9.5
1989-90	5.2	0.4	18.9	20.2	7.4	2.0	11.2
1990-91	5.2	3.9	15.1	15.4	10.3	13.7	8.4

Source : RBI Report on Currency and Finance 1986-87 and 1989-90.

In India during 1983-84 to 1987-88 average annual growth rate of GNP was 4% and the growth rate of money supply was 16%. There was a substantial excess of the money supply.

The excess of money supply in the Indian Economy can be measured as shown in Table No.18.

Table No.18: Measurement of Excess Money Supply in the Indian Economy (percentage change over per year)

Particulars	1986-87	87-88	88-89	89-90
A) Average annual growth rate of potential or actual				
1) Money Supply	18.8	15.7	18.1	18.9
2) GNP	3.6	3.6	10.8	5.2
3) Inflationary Gap	15.2	12.2	7.3	14.7
B) Permissible growth by Kumarswamy Theorem				
1) Money Supply	7.2	7.0	21.6	10.4
2) Real GNP	3.6	3.5	10.8	5.2
3) Inflationary Gap permissible	3.6	3.5	10.8	5.2
C) Excess of Inflationary gap caused by non-economic developed factors like maint. of non-productive public enterprises.	11.6	8.7	3.5	9.5

Source : RBI Bulletin (various issues)

The Table No.18 reveals that the actual money supply in India is more than the money supply permissible. The actual growth rates of GNP and permissible growth rates are same in different years. The excess money supply caused the inflationary gap.

The actual money supply in 1986-87 over last year was 18.8% which is more than the money supply permissible by the Kumarswamy Theoram 7.2% which caused excess of inflationary gap of about 11.6%. In 1987-88 the actual growth rate of money supply was 15.7% against money supply permissible 7.0%, which lead to excess inflationary gap about 8.7%. In 1988-89 the actual growth rate of money supply was 18.1% which was less than the required money supply i.e.21.6%. The actual money supply was less than the permissible money supply but there was inflationary gap about 3.5% . In 1989-90 again the actual money supply increased to 19.9% against the permissible money supply of about 10.4% which lead to inflationary gap of about 9.5%.

From this table it can be understood that inflationary gap does not completely depend on money supply. It depends on the growth rate of GNP. That is in 1988-89 though the money supply has increased the inflationary gap had decreased from 8.7% to 3.5%. A decrease in the GNP growth rate from 10.8% to 5.2% in 1989=90 leads to an increase in inflationary gap.

It is not correct to say that money supply does not cause inflationary gap. In 1986-87 there was inflationary gap due to excess money supply. And the decrease in money supply in 1987-88 with constant growth rate of GNP led to a decrease in the inflationary gap.

The Table No.19 shows the relationship between the GDP at current prices and deficit financing, total tax revenue, total revenue in remaining. The GDP of India increased from Rs.39708 crores in 1970-71 to Rs.34896 crores in 1988-89. The tax revenue has also shown an increasing trend from a small amount of Rs.2451 crores in 1970-71 to Rs.45353 crores in 1990-91. Similarly, there has been a fairly substantial movement in the total revenue from Rs.3342 crores in 1970-71 to Rs.58088 crores in 1990-91.

The volume of deficit financing increased from Rs.58 crores in 1970-71 to Rs.7337 crores in 1989-90.

The proportion of deficit financing to GDP of total tax revenue, of total revenue to GDP and of total tax revenue to total revenue have been shown in Table No.20. Deficit Finance as a proportion of the GDP at current prices has been increasing from 1970-71 onwards

Table No. 19 : Relationship between GDP at Current Prices and DF, TR, Total F and GPL.

Year	Deficit Financing (Rs.in Crores)	GDP (Rs. in Crores)	Total Tax Revenue (Rs. in Crores)	Total Revenue (Rs. in Crores)	General Price Level (1970-71 = 100)
1970-71	58	39708	2451.3	3341.9	100
1971-72	654	71201	6009.8	8075.4	173.0
1980-81	3451	122226	9387.8	12484.0	281.3
1981-82	2519	142876	11573.0	15739.7	288.7
1982-83	2350	158851	13056.4	17506.8	316.7
1983-84	2135	185991	15476.4	19717.0	338.4
1984-85	5105	207869	17693.7	23549.4	357.8
1985-86	3439	234159	21179.5	28043.9	376.8
1986-87	9283	260442	24362.5	32949.8	405.4
1987-88	6247	294408	28068.0	37029.8	435.3
1988-89	7940	348896	33853.7	43592.1	-
1989-90	7337	-	37853.7	52200.9	-
1990-91	-	-	45352.8	58087.8	-

Table No.20 : Deficit Finance as a percentage of GDP, Total Tax Revenue as a Percentage of GDP Total Revenue as a Percentage of GDP Tax Revenue as a percentage of Total Revenue and General Price level (1970-71 = 100)

Year	Deficit Finance as % of GDP	Total Tax Revenue as % of GDP	Total Revenue as % of the GDP	Tax Revenue as % of Total Revenue	3 - 2
	1	2	3	4	5
1970-71	0.15	6.17	8.41	73.35	2.24
1975-76	0.32	8.43	11.34	74.42	2.91
1980-81	2.82	7.68	10.21	75.20	2.53
1981-82	1.76	8.10	10.60	76.44	2.50
1982-83	1.47	8.21	11.02	74.58	2.81
1983-84	1.15	8.32	11.60	78.49	3.28
1984-85	2.45	8.51	11.33	75.13	2.82
1985-86	1.46	9.04	11.98	75.52	2.94
1986-87	3.56	9.35	12.65	73.94	3.30
1987-88	2.13	9.53	12.58	75.80	3.04
1988-89	2.27	9.68	12.49	77.66	2.81
1989-90	-	-	-	72.51	-
1990-91	-	-	-	78.07	-

though haltingly. This proportion has changed from 0.15 percent in 1970-71 (minimum) to 3.56) percent in 1986-87 (maximum). The total tax revenue as a porportion of the GDP and total revenue as a proportion of GDP have increased almost continuously over the period 1970-71 - 1988-89 the data indicate that most of the government revenue emanates from taxation. The proportion from other sources towering around 3 percent (of GDP). Thus, the share of tax revenue in the total revenue is substantially high and is increasing.

The lack of manoueverability of the government and degree of freedom that it can enjoy with respect to total revenue collections and therefore the deficit financing is limited. As has been seen earlier the deficit is mainly due to a growing current account expenditure. Thus bodes ill for the economy as a whole. In fact, one might be tempted to over to the fact that the general price index has shown a continuous increase over the period 1970-71 - 1986-87. Admittedly the rise in the index of the general price level cannot entirely be explained by the increases in the government deficits and the method employed for bridging this deficit. However, on a reasonable basis one can conclude that there appears to be a definite relationship between deficit financing and the general price level.