CHAPTER-VI

SUMMARY AND CONCLUSION

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The summary and conclusions emerging from the foregoing analysis are presented below. "Fiscal Policy for Economic Stability with special reference to India", is the subject of this dissertation. The study aimed at findingout whether the fiscal policy could be an effective instrument in bringing about economic stability in developing countries like India.

The first chapter of this dissertation deals with the review of classical approach of fiscal policy.

After careful examination of classical approach of fiscal policy we come to the conclusion that the classical principles of public finance would not only be irrelegant but also misleading in the case of developing countries which are trying to initiate a process of rapid economic development. Classical Theory of Fiscal Policy is only useful or relevant in the static economy or free capitalistic economy. It is irrelevant in the context of a developing country like India. The nature, characteristics and problems of developing countries are far different from developed countries. Therefore, the orthodex maxim of fiscal policy is is not suitable. Their concept of full employment, balanced budget etc. are more or less incosistent with development requirements and development programmes. More important, the problem of instability did not exist in the classical framework. Therefore, the classical concept of public finance is irrelevant to developing countries like India where problems of instability continuously crop-up.

Chapter No. II is devoted to the Modern Theory of Fiscal Policy. This chapter covers the ideas of Modern Economists like J.M. Keynes, A.P. Learner, Harrod Domar etc. who rejected the traditional ideas of classical economists.

The concept of functional finance is also discussed in detail in this chapter.

The principle of functional finance was extended further by Harrod and Domar, to the analysis of long term economic dynamics. They advocated the policy of maintaining steady and stable growth of output at full employment.

In their analysis fiscal policy plays a crucial role as a stabilisation and developmental factor in a developing country. In a developing country like India, there are number of problems like, lack of capital formation, increasing non-developmental expenditure etc. These problems ultimately result into inflationary situations and lead to instability.

We can conclude that modern fiscal policy based on Keynsian analytical framework becomes a more realistic and positive approach to the problems of developing countries. Of course, the Keynsian fiscal policy mix is basically tailored to suit the requirements of the developed capitalist economy. However, with appropriate modifications and qualifications, the instrument of Keynsian fiscal policy may be applied effectively in tackling the developmental problems of under-developed country. In this effort, what is required is a very delicate precise, balancing of various fiscal forces released by adoption of the modern fiscal policy.

Chapter No. III throws light on the objectives of fiscal policy in India and at the end, discusses throughly the concept of economic stability. Five major objectives of fiscal policy in India have been taken into consideration. They are development, employment, social welfare, defence and price stability. The development objective has been the most important objective, of fiscal policy during past three decades of Indian economic history. Resource mobilisation for economic development has been accorded primery importance over other fiscal objectives. It is beyond dispute that capital formation occupies a central and strategic position in the progress of economic development. For the capital formation increasing proportion of national income must be saved and invested in the real capital goods. Resources are required to be mobilised for capital formation through taxation, public borrowings, deficit financing and foreign aid. Expenditure on infrastructure facilities is also useful for economic growth. In recent years, it was Rs. 14,838 crores in sixth five year plan.

The second objective of fiscal policy is to secure high employment level. It has been mentioned as one of the objectives of economic planning in India in all the five year plans, but it has never been accorded a high priority. The problem of unemployment in developing country is basically different from developed countries. In U.D.C. like India most of the unemployment is due to structural backwardness, under development of industries and small size of service sector. Unemployment in an U.D.C. is both open and disquised. In India disquised unemployment is found to a large extent. To remove such type of disquised unemployed mainly from agricultural sector to capital projects, it requires large investment and it is only possible, through the fiscal measures in the long run.

The social welfare is the third objective of fiscal policy in India. The establishment of socialist pattern of society through democratic process is an important objective of our social and economic policy. This was accepted in 1954 by the Government. There is striking inequality in India even after completion of more than 30 years of planning. Reduction of the inequality through the fiscal measures is one of the effective instruments for achieving the social welfare of the masses, but it is limited in extent. In all the plans this objective got a very low priority. It is stated that Indian plans have never made any serious attempt to redistribute income and wealth, but some welfare programmes were started. This objective of fiscal policy has not been successful in India.

The removal of poverty is also coinsidered objective of social welfare. In recent years the Government adopted fiscal measures to face the challenge of poverty. The Government paid adequate attention towards removal of poverty during the fifth and sixth five year plans. The slogan of 'Growth with Justice' and 'Garibi Hatao' indicated clearly the emphasis of the Government. In this regard number of welfare programmes were started.

Similarly, social security is one of the important characteristics of welfare state and was started in India after Independence. This scheme provides various benefits like sickness, medical, maternity etc. For this purpose Government spends large amounts of money. Besides this, Government provides all useful utility services to the people. Thus, directly or indirectly through the provision of utility and welfare services to the people, Government can achieve the objective of social welfare.

Recently in India, defence has become the important objective of the fiscal policy. This has been accepted even by the planning commission. Since 1962 more stress has been given on the strengthening of Indian Defence Department. The defence expenditure was estimated to be Rs. 5,700 crores in 1983-84.

Price stability is one of the important objectives of fiscal policy of developing countries like India. Price stability implies 'Maintenance of purchasing power of currency at a level which encourages investment, production, and employment without inflationary or deflationary price movement.' Rising or decreasing price level disturbs the pattern of saving and investment. Economic development and price stability are considered as antithetical joint objectives for developing countries. Government should achieve this objective through the fiscal, monetary and other regulatory measures monetary policy has a limited scope in the process of price stability. Consequently fiscal measures have to play an important role.

Finally, the meaning of economic stability is discussed at the end of this chapter. Economic stability cannotes, "A condition of high level economic activity with absence of severe cyclical fluctiona". Basically most economists would consider three aspects of economic activity relevant to the measurement of stability. They are production, employment and prices. If the economy suffers from either inflation or deflation it leads to economic instability. According to J.M.Keynes, divergence between money income and real income is an indication of rising or falling prices. A number of factors are responsible for rising prices (like deficit finance). But according to some other economists mild rise of 3% to 4% p.a. in general price level and deflation of prices at the same rates for few years after an interval of three years period is not to be considered as indicative of real economic instability.

The fourth chapter of this dissertation tries to establish the relationship between public expenditure and inflation. Public expenditure is one of the most important instruments of fiscal policy to achieve the objectives of state policy. The Government has to perform various functions. In order to perform these functions it has to incur expenditure. After independence public expenditure has increased tremendously e.g. The public expenditure in 1950-51 was Rs. 91 crores only and it rapidly increased to Rs. 29146 crores in 1983-84. It was continuously rising though by fluctuating rates. This huge growth of public expenditure is the combined outcome of a number of factors like population growth, ~~repaid~~ rapid growth of urbanisation, defence service, welfare functions of the state, transport and communication, debt servicing etc.

Similarly, when we look at Developmental and non-developmental expenditures we can say by observing data given in Table No. 3 that both D.E. and N.D.E. are increasing from 1970-71. Increase in N.D.E. is more than that of D.E. But here, it must be noted that D.E. is increasing at a faster rate than N.D.E. The amount spent on N.D.E. increased from Rs. 534 crores in 1950-51 to Rs. 2643 crores in 1970-71 and further, it increased upto Rs. 11590 crores in 1982-83. The proportion of N.D.E. to D.E. has always been very high except the year 1981-82. But it was declining gradually.

The gap between expenditure and revenue of Union Government is widening. The Tables 4 and 5 clearly indicate that net deficit has increased during the reference period. The deficit in the budgets have always increased well from the inception of first plan. In the first plan, deficit budget was Rs. 333 crores. It increased significantly in IVth and Vth plans i.e. Rs. 2047 crores and 1218 crores respectively. In the VIth Plan, during the first three years, deficit incurred was Rs. 6562 crores. The increasing deficits had great inflationary effect.

Price stability is an essential condition for healthy economic life, as well as for economic growth. The process of price rise started in India with the beginning of the second five year plan. When we examine the price level movements during the planning period we find three clear phases.

1) Period of stable or declining price level during first plan period 1951-56.

2) Period of steady rise in price level during 1956-72.

3) Period of ~~rapidly~~ rapidly rising price level during 1972 to 1982-83.

Increasing general price level is the result of increase in money supply. Therefore, the trend of money supply has also been shown and discussed. (M') money supply is defined to include currency with public and net bank deposits. Money supply has continuously increased except the year 1977-78. When we consider the whole planning period we find that there is no clear pattern in the magnitudes of changes in the money supply on the one hand and wholesale price index number on the other. At the end of this chapter we have tried to establish the correlation between PL, NI, M' and D.F. However, the exact nature of these inter-relations cannot be specifically quantified and expressed in definite quantitative statements. At the most we can say that changes in the price level are the composite result of the factors mentioned above. Moreover, we cannot disregarded other factors like black money, artificial scarcity, foreign exchange problems, taxation, etc. which certainly have some effects on the price level.

In a developing country like India, democratic planning entails huge public expenditure for both D.E. and N.D. purpose. This leads to increasing reliance on deficit financing. However, the rate of growth of national output remains low for a variety of reasons. This inevitably causes the inflationary situation and resultant economic instability.

Chapter No. V discusses the nexus between level and composition of taxation on the one hand and price level on the other hand. Initially, an attempt is made to explain theoretically the possible effect of taxation on price level. As a generalisation it can be said that if the growth of real output is slow and the growth of monetary output is fast, increasing level of taxation will cause following effects on the price level :

i) If direct taxation constitutes a large proporation of total taxation, the rise in price level will not be very rapid so as to create problems of economic instability.

ii) On the contrary excessive reliance on indirect taxation will lead to a rapidly rising price level through the process of cost-push inflation.

In India tax policy has been gradually so formulated as to achieve the following objectives :

i) To reduce disparities in the income and standard of living.
ii) To fight against inflation, deflation and stagflation
iii) To minimise the quantum of deficit financing.
iv) To rationalise and simplify the tax structure in order to encourage saving and investment.
v) To make tax policy an instrument of capital formation for economic development.

It is, however, clear from the statistical analysis that the actual structure of taxation that has evolved so far in India cannot be said to be appropriate for the same. More particularly the excessive dependence on various indirect taxes can be considered as one of the major causes of increasing price level.

It, however, seems that it is very difficult for Indian public finances to escape out of the predicament of increasing need for revenue productivity and the need for noh-inflationary effects of the tax system.

The specific conclusions regarding the level and the composition of taxation vis-a-vis price level stability can be stated in the following way.

i) For stability purposes Indian fiscal policy has not made use of direct taxes in the expected manner and to the necessary extent.

ii) Because of over-whelming proportion of indirect taxes mainly in the form of customs and excise duties at the central level and the state excises, sales taxes which also bear heavily on the price level. The objective of stability could not be achieved to the desired extent. Infact it can be said that excessive reliance on indirect taxation has led to the cost push inflationary conditions.

iii) It is in this light that we can say that how a major shift in the tax composition is a overdue. Various direct taxes must be used more effectively and proporation of indirect taxes must be reduced significantly. Similarly, whatever indirect taxes remain they should be made more progressive and neutral as far as possible with regard to industrial and agricultural output.

From the foregoing a broad pattern of generalisations regarding the efficacy of the fiscal policy for economic stability in a developing country like India can be summed-up in the following statements :

i) The growth of non-developmental expenditure needs to be properly and strictly regulated in order to minimise its effects on price level. (Mainly the inflationary pressures).

ii) So far as deficit financing is concern, a more rigorous planning and implementation of deficit financing has become imperative.

iii) In the field of taxation greater reliance must be placed on wider use of direct taxation coupled with a reduced but a more progressive use of indirect taxation, mainly the commodity taxation. It is only when these conditions are fulfilled that the objectives of growth with stability can be meaningfully achieved.