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Economic Growth vs. Fiscal Deficit: Issues and challenges of a growing fiscal deficit.

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Economic growth is essential for economic development, to achieve high pace of economic growth in the era of globalization more investing activities required in the economy by government to maintain the pace of growth. For which government may run out of budget as they spend more form their budget and running out of budget due to which they might face situation of fiscal deficit. So, a rising fiscal deficit is not only essential but also crucial for economic growth. To achieve even a moderate pace of growth, a choice of expansionary fiscal policies becomes essential particularly in emerging economies. In the context of Indian economy, a continuously increasing Non-plan expenditure (consisting of interest-payment, defenses expenditure, pays and allowances, pension, and subsidies) as compared to plan expenditure is major reason behind growing fiscal deficit in India. In view of this, it is suggested that government should make viable trade-off between economic growth and fiscal deficit. There is a strong need for effective implementation of Fiscal Responsibility Budget Management (FRBM) Act. This being a joint responsibility of center and state government, a special incentives should be provided to those states which meet the FRBM targets as this will encourage others to make continuous efforts to keep their fiscal deficit within the ambit of Act. Further, Non-plan expenditure should be reduce, subsidies should be targeted to vulnerable group only and more emphasis should be given to the poor class, and their effective monitoring and transparencies will improve fiscal position in many ways.

Key world: fiscal deficit, economic growth, public debt.

JEL Classification : D14, E62, H53.

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INTRODUCTION

Economic Growth and Effects of Fiscal Deficits on an Economy

Economic growth can be explain in a simple way where there is an incremental changes in the national productivity or potential of the economy which are measured in term of monetary value in term of country specific real level of output over a period of time. In well manner reflect country's GDP. Economics growth coined in term of quantitative aggregates and generally argued that leave other important factor behind which were included in Economic Development. However, there may be case of that Economic growth and development are complementary but most of the nation's studies find that there is huge gap exist between two concepts. In which former term excluded qualitative measure, which helps to raise living standard of society also included Institutional setup and reforms, while latter included these all aspects and now in era of fast globalization it has more broad objective called sustainable development.

An economic growth is the vital for the economy and its tendency to grow continuously is the need for present. As the economies become more competitive in the era of globalization, modernization and liberalization because every economy is seeking to reap the benefit of trade or simply called a gain from trade in the term of gaining a sound growth rate, huge output, growing employment with specialization of factors (i.e. input or labor) as the theory suggest. Further the Economic growth is the critical for the Economic Development to achieved descent level of living standard with providing certain welfare status: so an opportunity lies with those economics that have the high pace of growth, which measure in the term of GDP.

However, Economic growth is the subject of sudden shocks in both short-term as well long-term due to both internal or external factors which suddenly destabilized the pace of growth dampened the economic activity and productivity in the term of slowing down the growth rate (i.e. recession, deflation etc.), as output falls and unemployment surge which have further impact of falling investment in the economy as well aggregate demand. This is well known Business cycle which has all phase of boom, burst, in boom or euphoria economies shine with high growth rate and business activities on the peak so, government earn huge revenue in the term of collection of tax revenue, duties and revenue from tariffs in another way government reduce public investment because private investment is enough in the economy to maintain the pace of growth so in net term government run with surplus where government need little effort to maintain stability, but in opposite , the level of investment falls and contraction occurred in output, employment and business activities, finally during the burst growth dampened and output falls government use proactive policies to maintain stability in the economy and intervention took place in the term of huge expenditure as public investment increases over private investment with consequent effect of crowding out effect.

James M. Buchanan contains ten monographs, two of which deal specifically with public-debt finance: *Public Principles of Public Debt* originally published in 1958.

So, In order to prevent from shocks government took some effective measurement in the form of huge spending, increasing the level of Investment in the economy, of which the net effect is to saving of government falls or called it govt. dissaving means government is running out of money or deficit in the their Budget. If deficit is financed by printing money have inflationary trend due to increasing money supply and enhancing the purchasing power of individuals have miss-allocation of resources and unequal distribution. But in the case if government fiancé this deficit via issuing bond or borrowing from public what would happen? The answer is that it had further adverse impacts in social and distributive justice in term of utility loss (1) by different group particularly taxpayers.

Fiscal Deficit: A Perspective: The fiscal deficit has been always debatable issues between among the economist, policy framer, and politicians. However some notable economist have in favor of government spending and encourage fiscal deficit as a one of the most important tool for rebounding economic growth, by running large fiscal deficits. Sometimes, these deficit are run to expand popular policies, such as welfare programs to create more surrounding activities in the economy.

To keep the growth Growing fiscal deficit and Economic growth: So, to impute the level of growth government spending become critical but excessive spending further lead to repercussion in the economies in the term of huge cost in the term of rising interest rate, increasing cost of capital as well growing deficit become the menace of government balance sheet and once government starts spending it's $\Delta G > \Delta T$ (i.e. spending exceed tax revenue) growing deficit increase borrowing and also raise the interest liabilities to the government as well inequality and misallocation of resources.

Theory of Debt-Burden and Fiscal Growth

To attain the pace of growth choice of expansionary fiscal policies become essentials particularly emerging economics like India as the economist suggest that the vicious cycle of poverty could be decomposed when government make huge effort and push-up the level of Investment to providing public goods and to setup public sector for balance and inclusive growth. An expansionary policies or excessive spending also affect to the rate of growth in the term of crowding out (physical crowding out, financial crowding out) or if higher deficit is finance via by issuing bonds have sever consequence of fiscal illusion (1) - As bondholder reduce their present consumption to earn higher return in the term of interest-payment in the future and this can be compensated by taxpayers by sacrificing future consumption, further interest payment have adverse impact on wealth because it reduce the consumption of future as Buchanan phrases it,

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> *"by financing current public outlay by debt, we are, in effect, chopping up the apple trees for firewood, thereby reducing the yield of the orchard forever"—J M. Buchanan.*

However other theories become neutral about shifting

Table (i) Comparative Analysis of growth rate and fiscal deficit					
Three year Aggregate		Growth Rate	share of Fiscal Deficit/GDP		
1977-79		2.9	-3.8		
1980-82		5.6	-5.5		
1985-85		5.6	-6.9		
1986-88		6.4	-7.8		
1989-92		4.3	-6.9		
1993-95		5.9	-6		
1996-98		6.1	-5.2		
Source: Surjit S. Bhalla (Research & Investment, New Delhi)					

of debt burden and enunciated the proposition that the public loan and extraordinary tax exert equivalence effect on the economy under Ricardian Equivalence (2) theorem.

Finally, it was only Keynesian (3) who expresses that governments need not balance their fiscal books and instead should use deficit finance as a cyclical device for stabilizing the economy, in essence he support for increasing deficit and argued that size of fiscal deficit does not matter during the slowing down of economic growth and become fiscal instrument to maintain the enough level of investment in the economies for keeping stability and growth, he further argued that deficit can be repaid or minimized at the time of when economics are performing well by reducing the level of public investment, sharp reduction of subsidies, and raising tax revenue which reduce the deficit on government budget, so expansionary fiscal policy become important instrument to maintain the pace of growth and excessive deficit can be bring down during the Euphoria in the economy, the empirical evidence had shown in the 1930s depression period when the Keynesian economics widely recognized.

An Indian outlook: a comparative analysis

Indian outlook of fiscal growth can be studies in the two parts of incidence first, period of pre and post Liberalization and, secondly the period of pre and post FRBM legislation, earlier period or pre-liberalization the Indian economics experienced of slower growth with high deficit as shown in the table-(i) which shows as Growth increases the share of Fiscal Deficit also increases, and this deficit particularly financed by external borrowing due to lack of domestic debt market and insufficient banking and capital market, which push the burden to the government to open the economy. So, financial reforms took place on 1991 when Indian economics was suffering of diseases of high burden of debt. After liberalization there was sharp decline in share of fiscal deficit to GDP ratio as compared to pre-liberalization period due to opening up the market, allowing international players in the domestic markets to bring competition and efficiency and allow private entrepreneur to become the part of growth story by investing in the profitable business. This one side encourage to the production or called Product differentiation from demand side and scale of economics from the supply side and create more private investment which directly help to the government to reduce their level of investment in the economy. However a balance growth approach had been addressed by establishing heavy industrial sector in the areas where private entrepreneur were not interested due to lack of profitability so it becomes the responsibility to the government to make viable investment and create infrastructure for the future growth (Table 1).

It create extra burden of debt to the center including states, due to which consolidate deficit was also high however it was aimed that it should not be more than 9 percent of GDP in the future, further it was said that state should understand their responsibility and reduce their own deficit within the ambit. As high deficit bring inflationary situation in the economy due to misallocation of resources which happened in the Indian case till recent experience has shown that a expansionary fiscal policy as well Monetary policy bring inflationary trend in the Indian economies which often create havoc and instability in the prices and falling value of Money.

The Fiscal Responsibility Budget Management Legislation

The FRBM Act was passed in Indian parliament on 2003, to limit the borrowing capacity of central government and target the bring down growing size of fiscal deficit which became menace as it had adverse impact on government balance sheet, till there were no limit was decided of borrowing which causes continuous increasing burden of government liability.

Table 2. Achievements through FRBM: Key Deficit Indicators

	Gross Fiscal Deficit of Centre	Revenue Deficit of the Centre	Combined Fiscal Deficit	Combined Revenue Deficit
1986-87	8.37	2.5	9.8	2.42
1998-99	6.47	3.8	9.0	6.32
2002-03	5.90	4.4	9.6	6.63
2003-04	4.46	3.6	8.5	5.76
2004-05	4.02	2.5	7.5	3.67
2005-06	4.11	2.6	6.7	2.66
2006-07 RE	3.69	2.0	6.4	2.05
2007-08 BE	3.39	1.6	5.8	1.22

Source: CBGA [(i)], India

Originally, the concept of FRBMA come from France and binding to all EU members for their membership in the European Union, Indian has actively implemented the FRBM Act on 2004 with the following objective including (i) transparency in the fiscal management (ii) bring long term fiscal stability in the economy (iii) better public debt management, keeping target to bring down Fiscal Deficit upto 3 percent of GDP and Revenue Deficit upto 0.5 percent of GDP by march 2009, under Tenth five year plan and also bring down fiscal deficit by 0.3 percent of GDP at end of every financial year, and it should be considered in conjunction with combined (center and states) debt-to-GDP ratio upto 68 percent on 2014-15 from current level of 82 percent under Thirteenth Finance commission report which has been actively implemented in the Budget of 2010-11 to effective management of public expenditure via proper targeting subsidies was the key of fiscal management.

The success of FRBM Act however remain low due to global financial crisis, But just after implementing of FRBM there was drastic decline in the deficit to control inflation, and this can be seen in the Table-1: shows deficit of Pre-FRBM and Post-FRBM period as gross fiscal deficit which stood around 8 percent on 1986-87 have been declined continuously, as well combined fiscal deficit also decline sharply after FRBM legislation, but not able to attained target due to wake of global crisis which affect demand in the economy and slowing down the phase of growth, investment and business activity by dampening economics activities. (Table 2)
which force government again to take fiscal instance from demand side component for generating national income aggregate and manifest in the rate of growth by providing gross capital formation which stood 35 percent on 2008-09 and further raised upto 38 percent 2009-10, which further increase the burden of debt and again fiscal deficit rose upto 6.8 percent on 2009-10 (BE) [i]. Including revenue deficit at 4.8 percent on 2009-10 (BE).

The other consequences were lower growth rate during the crisis and high inflation with touch double digit, inflation raise many questions that is high fiscal expansionary policy have inflationary effect?. And focus the future need of immediate cutting down fiscal deficit at safer level.

Cause of growing deficit: There were several factors of which major composition of growing deficit is continuous increasing Non-plan expenditure as compare to plan expenditure as shown in the Table:2, Non-plan expenditure remain almost double to plan expenditure, Non- plan expenditures consist interest-payment, defense expenditure, pays and allowance, pension, subsidies and other. Growing interest payment due to excessive government borrowing, excessive burden of pays and allowance for 6th pay commission put further burden of fiscal deficit. In case of Revenue Expenditure the major component of interest payment was the highest and stood around 34 percent of total revenue expenditure on 2003-04 which bring down significantly upto 24 percent on 2008-09 and onwards 2010-11 a Budgeted Estimates it rose further upto 25.9 percent, second item remain Subsidies which stood about 12 percent on 2003-04 to 15.6 percent on 2008-09 and remain 11.4 (BE) percent upto 2010-11.

Other reason of growing fiscal outlay due to continuously falling share of Non-tax revenue in the Revenue Receipts due to losing out control in the public sector via disinvesting where government lost revenue in the term of royalty and dividend which they earn from public sector has sever effect the balance sheet of the government. (Table 3)

However, in recent day's government make serious effort to (i) maintain the pace of growth, and (ii) bring out more transparencies in the public debt management through disinvestment of Public units, including disinvestment of telecom licensing fees including 3G and BWA (1.5 percent of GDP) raise revenue to the government which helps government to reduce the

Table: 3. Plan and Non-Plan Expenditure of Central Government

	Plan Expenditure	Non-plan Expenditure
		Rs in crore
2005-06	140638	365100
2006-07	169860	413527
2007-08	205082	507589
2008-09	275235	608721
2009-10 BE	325149	695689
2009-10 P	302199	716327
2010-11 BE	373092	735657

Source: Economic Survey, 2011

Table 4

Projection of Centre's Resources for the Twelfth Five Year Plan (2012-17)							
Description	**2011-12 (BE) Base Year**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**XIIth Plan Total**
Gross Domestic Product	8,980,860	10,283,085	11,774,132	13,481,381	15,436,181	17,674,428	68,649,207
Fiscal Deficit	412,817	421,606	412,095	404,441	463,085	530,233	2,231,461
(Figures in Rs Crore at Current Prices)							

Note: *These figures are tentative and subject to revision when the final report of the Working Group on Centre's Resources for the Twelfth Plan becomes available.*

burden of deficit, however this option is not available for longer period now the option remain with disinvestment of others PSU's which not only bridge the gap to reduce fiscal deficit but also bring better management and best practice of corporate governance in the public sector with efficiency and better utilization of resources, the disinvestment bring transparency in the management and its operation become smooth as disinvestment influx more capital and efficient human capital.

In against argument of disinvestment is loss of revenue receipts due to lower stake in the PSU's, as disinvestments reduce revenue receipts to the government loss of dividend, royalty etc. This can be compensated only by improving tax base and government took serious effort to raise and simplified tax proceeding by adopting Direct Tax Code Bill-2010, which facilities of voluntary compliance and improving tax to GDP ratio.

Towards the Future

The objective of the Eleventh Five year plan (From 2007-08 to 2011-12) was more focused on inclusive and faster growth with creating enormous opportunities of employment, income generation including generation of resources, reduction of poverty, to achieved these objective the growth rate were targeted 9 percent per annum which initially behave good in the growth front but due to global turmoil did not achieved targeted and with the average growth rate of 8.1 percent better than Tenth Five year plan growth rate 7.8 percent. (Table 4)

The Draft of New Twelfth Five year plan has been prepared with the objective of more inclusion of all sector with sustainable manner and inclusive growth, the inclusion are multi-dimensional concept and address all areas including health, education, energy, infrastructure with special attention of reduction of poverty as suggested by Tendulkar Committee a Expert Committee setup by Government of India, as ambitious target setup for reduction of poverty by 2 percent point per annum in the Eleventh Five year to achieved the targeted growth rate of 9.5 percent and inclusion all sector required little higher allocation in the Budget this will put excess burden on government Balance sheet. The Table shows the Projected GDP and fiscal deficit for the Twelfth Five year plan a Draft prepared by planning commission of India showing increase in GDP have also impact on growing

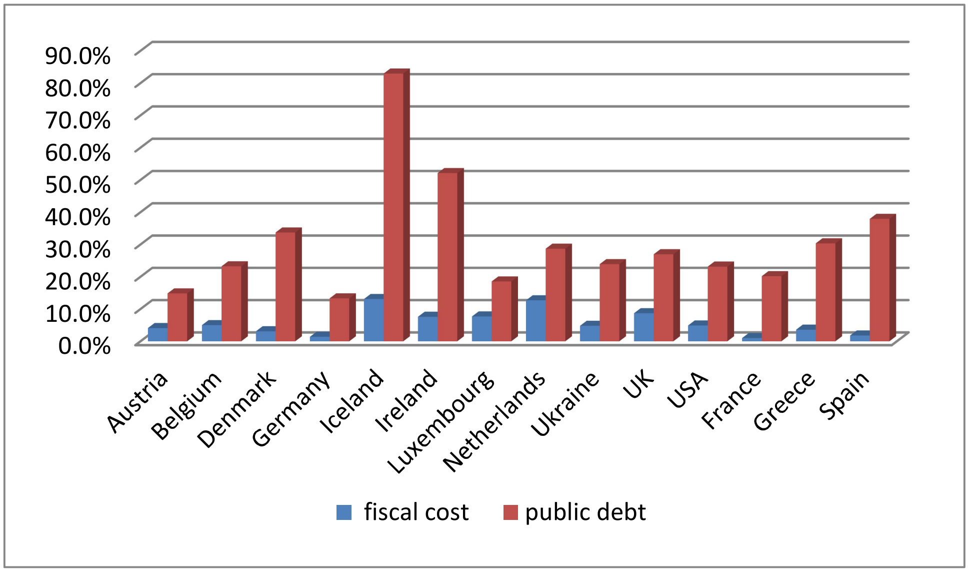

Figure 1. comparison of fiscal cost & publci debt as % of GDP
Sources: database by Luc Laveven & Fabin (June 2010) of IMF.

fiscal deficit and Total GDP for the Twelfth plan are projected Rs 68,649,207 crore against which fiscal deficit was projected Rs 2,231,461 crore however the fiscal deficit was kept with the ambit of Fiscal Responsibility Budget Management Act to keep low fiscal deficit with high growth rate while aiming inclusive growth which required continuous running flagship or welfare programs including MGNREGA, JNNURM, IAY, NRHM, Indira Awas Yojana (IAY), Pradhan Mantri Gram Sadak Yojana (PMGSY), Sarva Siksha Abhiyan (SSA) are the Important. To achieve those target required strong management and execution of financial resources and generation of addition resources for future to attain inclusive and sustainable growth, it can be possible only by continuous control and monitoring, effective planning and implementation with equal effort of both Center and States.

Global Outlook: Growth versus Deficit

The Global GDP is growing at the rate of 32.2[i] percent as on 2001 of which Advance economics share stood around 25.7percnet and share of developing & emerging economics stood around 6.7 percent, India's share to the world GDP is just only 1.5 percent on 2001. While advance estimates shows that developing economics will take over to advance economics in the term of GDP over next three decade, of which Indian will be one of the fastest growing economy, as recently, developing economies have experience of higher growth from the beginning of 20th century; the contribution was mainly leading economy such as China and other Emerging Economies. In essence the BRICS [ii] counties were growing more faster than Industrialized countries, in the term of growth rate China took over Japan economies which shows shining of Asian giants with huge surplus in their Balance of Payment while the nature of surplus was quite different and Industrialized economics face sever deficit in their BOP including U.S. EU having experience of slowing down growth rate, low interested rate, rising fiscal deficit or public debt. A further pressure was put at the global crisis and severity of global crisis spread in the whole Euro area and other advance economics and severity of crisis create fear in the Europe as most of the Euro member countries growth was stagnant with high inflation and huge deficit.

Most effected economics within the Euro Area were known as a PIIGS country (i.e. Portugal, Iceland, Ireland, Greece and Spain) of which growth rate almost nil or Negative and facing high debt-to-GDP Ratio more than three digits create havoc over the world. These counties are not able to insolvent and most of the debt fiancé by EU's member particularly, Germany, France, and IMF bailout package effort to rescue from Debt-Trap. (Figure 1)

The excessive rescue/bailout package increase fiscal cost due to socialization of Risk which burdened was transferred to investors or public in the way of high tax rate, and raising money from the public via issuing bonds by the government and creates inequality. Fiscal cost and public debt of advance economics shown in the Table-3 clear that how countries face sever debt crisis, push Chronic Fiscal Imbalance*, greater income disparity, chronic unemployment, volatility in agriculture prices, unmanageable inflation and finally hurt the Economic growth rate which have further repercussion on economic disparity and slow growth rate over the world which represented in the framework shown in the chart clear understanding of fiscal imbalance.

SUMMARY AND CONCLUSION

To define clearly the Limit of fiscal deficit one of the difficult tasks, no one has correct explanation of fiscal deficit and cannot disagree to the fact that fiscal deficit are not vital for the economic growth and development. In fact fiscal deficit become one of the major component to boost the growth rate, as noted economist suggest that if a particular economies are interested to reap the benefit of high growth than they must increase their Investment or Expenditure for production activities, an excessive expenditure however put extra burden to the government but if the economy have the experience of high growth rate they will reap all benefit of the high growth and development which raise the enormous resources for the countries including huge tax revenue that make sound surplus in the Budget as well government can reduce their size of deficit by reducing the cutting unnecessary expenditure.

In the context of Indian economy government should make viable trade-off between economic growth and fiscal deficit and strong need to effective implementation of FRBM Act. A joint responsibility of center and states, a special incentive should be provided those state who met the FRBM targets, this will encourage to effective implementation and continuous efforts to keep fiscal deficit within the ambit of Act. Further, Non-plan expenditure should be reduced, subsidies should be targeted to vulnerable group only and more emphasis should be given to the poor class, and their effective monitoring and transparencies improve fiscal position in the many ways.

The Global Economics are facing severe financial crisis with high burden of debt with almost stagnant growth rate including alarming rate of rising unemployment, inflation, put pressure of fiscal reform in for breaking the chronic disparity cycle.

The present need to develop problem oriented fiscal reform and effective policy and instrument to target multi-variable problem for solution, to address special problems such as climate change, inclusive growth, and sustainable growth requires coordinating approach, sharing of information, knowledge, technologies and research activities can make possible to achieved desirable objective and harmonious growth over the globe, but to accomplish this task a initiatives required and binding commitment towards partner is vital, from the last two decade it seems that countries are more serious toward the common problems and have special address to raise questions for solution and their contributions to combat with many problems including good securities, sustainable growth, money laundering and terrorism etc. are now global issues and world leading groups are very serious toward the issues, which make possible to binding countries for commitment in different forum/conference and publish reports, database, and research to provide all necessary information to all members which become the positive aspect and shows how serious are the countries for inclusive and sustainable Growth and Development.

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