Chapter I
INTRODUCTION

1.1 Importance of Study

The philosophy behind economic planning underlines the fact that markets and price system alone cannot ensure welfare of the citizens of a state, while individuals are the best judge of what is good for them, the sum total of such judgment need not be the best option for the society as a whole. Moreover areas like infrastructure require larger investments without immediate tangible returns and therefore do not attract private investment. Finally Government provides for some goods such as the quality of environment and national defence, which can be enjoyed by one person without depriving others of similar enjoyment. Private sector will not invest in public goods as there are no direct returns. All these factors justify government intervention in the economy though the degree of intervention is a matter of political ideology. "The failure of the philosophy of the self interest propounded by Adam Smith necessitated the state to undertake the development task. It requires the deterioration and chalking out a program of development efforts. It may be executed by the state. The state intervention in the economic field is considered justified in view of the imperative need of economic development".¹

The hindrances in the way of development of those countries which are poor is quite difficult to overcome,
unless there is a state intervention and through a process of systematic planning because steps have to be taken to raise the economy from the stagnant condition which is due to scarce capital abundant labour and low productivity per worker. The Government is expected to take steps to raise the economy from stagnant condition by playing the role of entrepreneur and break the vicious circle of poverty and for this mobilization of resources is required which is the most important task before the Government.

Mobilization of resources is a dynamic concept and as the economic activities multiply, its prospects become brighter, the potential resources become actual and is concerned with the creation of additional savings in the economy and directing them towards those form of savings which is desirable and then promoting the non speculative and productive investment and for this the state has to play a dominant role because it is considered as a pious duty of the state to develop their economy and changing the deplorable economic condition of the people. Paul Streeton observed that "a large number of countries had achieved political independence and with it development aspiration". ²

The expanding size of India’s successive five-year plans has greatly increased the importance and task of the resource mobilization because the mobilization of resources for securing an adequate rate of growth is the crux of the problem of planning in a developing economy. Any plan
irrespective of its size can be implemented only when its scheme of financing is so devised that sufficient financial resources become available easily and for this the Government has to stretch to the utmost for squeezing the financial resources from every nook and corner and even from the foreign countries.

1.2 General Significance

For achieving a rapid rate of growth in the process of economic development large amount of national savings are to be invested in public as well as in the private sector. Apart from investment large amount of financial resources are required for meeting the current expenses of social services which are of non developmental nature (like education, health, social welfare and social security measures) and for expanding administrative machinery needed for the implementation of the plan. For meeting all these expenses financial resources are to be mobilized and this problem is basic to the whole question of economic planning.

There are various types of financial resources raised by the union and the state Governments to finance planned development. The selection of means of financing such as the taxes, deficit financing, external assistance etc and the extent to which these are used are of crucial importance because there are relative merits and demerits of each one of these sources and these have close bearing on the pattern
of distribution of the burden of development on different classes of people, general price level and the balance of payments as well as on the economy as a whole. It is obvious that no single source can be relied upon to meet all the requirements of finance. Therefore different sources will have to be made use of at the same time. The choice of an optimum combination of sources would depend upon several factors such as the relative contribution of each in the past, the socio-political situation at the time of the formulation of the plan and the level of development of the economy, moreover a particular combination will have to be reviewed in the light of the changing scenario. This is true in the case of Ninth Five Year Plan too. The Ninth Five Year Plan has been prepared in the context of four major dimensions of state policy and against a perspective of development of fifteen years. These four dimensions are (i) Quality of life (ii) Generation of productive employment (iii) Regional balance (iv) self-reliance.

For effective implementation of a plan, it is imperative to devise such a scheme of financing that adequate amount of finance is available and that too in desired quantities. For this it is necessary to make efforts to mobilize the resources. A scheme of collecting fund has to be devised. If funds are not available in required quantities, the achievements of physical targets of the plan becomes very difficult or impossible.
According to Alex Radian "Money alone, even when it comes in large quantities is not enough to bring about economic betterness but money is certainly a necessary condition. No amount of will power or talent can substitute for the lack of resources". ³

In short, the problem of raising adequate financial resources is an important aspect of implementation of the plan as physical resources can neither be allocated nor used unless adequate financial resources are raised.

1.3 Relevance of the Theme in the context of India's Financial Structure

The importance of planning lies in involving firstly a system of objectives to be pursued and secondly the optimal allocation and utilization of the resource of the country. According to Prof. Robbins "To plan is to act with a purpose, to choose and choice is the essence of economic activity. Every community has its own setup of values, which become the fundamental framework of reference for the success of a plan." ⁴ The targets laid down in the plan should be consistent with the financial resources available for this purpose. In the absence of adequate financial resources, there is little point in laying down the targets which may look quite impressive but may be totally unrealizable on account of paucity of funds and from this it is quite clear that mobilisation of resources is a pre-requisite for achieving an adequate rate of growth and
therefore its mobilization is the crux of the problem of planning in a developing economy. If sufficient funds are not available, the achievement of physical targets becomes difficult. Infact, the problem of mobilization of financial resources is an integral part of the problem of the plan implementation particularly because the ability to use and allocate physical resources depends to a large extent on raising of financial resources.

The Indian Planning Commission points out that “The essence of financial planning is to ensure that demand and supplies are matched in a manner which exploits physical potentialities as fully as possible without major and unplanned changes in the price structure”.

The sources of finance available to the Governments may broadly be classified into three categories.

Domestic budgetary resources are the funds raised by the Government within the country and they consist of

1) Balance from current revenues that is excess of current revenues over current expenditure.
2) Mobilization of internal private savings through market borrowings, small savings provident fund etc.
3) Contribution of public enterprises
Additional Resource Mobilization in the form of additional taxes and additional revenues from public enterprises

II.) The External Assistance consist of loans and grants from foreign countries, loans from International Institution such as the International Monetary Fund, the World Bank etc. After making strenuous efforts to raise as much resources as possible through taxation borrowing and external finances there may still remain a gap between available receipts and total investment necessary for rapid economic development, hence the Governments in such countries have to adopt the device of deficit financing as the last resort. The plan should lay down such policies and instruments for mobilizing resources which fulfill the financial outlay of the plans without inflationary and balance of payments pressure. At the same time, they should encourage corporate and household savings of the private sector.

A clear picture of the India's financial structure can be had by analyzing the different sources in detail.

Balance from current revenues - It is the difference between the current revenue receipts and the current expenditure of the Government. In India taxation is the main contributor to current revenue balance. In the past it has provided from 20 to 35 percent of the total financial resources required for the various plans. It is an effective instrument to take away
a part of additional income before it is distributed, moreover this source can reach the maximum number of people and it can make them pay. This can be achieved by judiciously combining the Direct and Indirect taxes. According to the Third Five Year Document “Direct taxation adds to the resources of the public sector by reducing disposable incomes in the hands of the community. Indirect taxation works through reduction in the quantum of goods or services that can be bought against the incomes that are spent. The choice between the two forms of taxation has to be considered pragmatically”. Taxation is the only instrument which can be manipulated in such a way that the tax revenue can be varied within a significant range in harmony with the changes in the size of national income, distribution of income and prevalent political situation. Quantitywise it raises the volume of public savings to be used for capital formation consistent with the growth of savings in the economy, qualitatively it directs the flow of resources into useful and productive channels of investment and prevents the resources from being dissipated over unproductive investment and luxury consumption. In view of the great importance of taxation for the finance of development a high ranking has been accorded to it in the Indian plans.

Domestic Private Savings: - It includes

(i) Market borrowings
(ii) Small savings

Although the classical economists suggested that this method of raising finance should be used only under exceptional circumstances but of late this source has occupied a significant place in the scheme of financing of five year plans due to the fact that, there has been a change in the economic thinking brought about by Lord. J.M. Keynes and secondly the Government has a good and extensive capital market in the form of Nationalized bank, public sector financial institutions, Public Provident Fund etc which will be able to supply almost any amount of funds needed by the Government. The First Five Year Plan observed. “Techniques of borrowing, in particular, have to adopted so as to convey to the people the larger purpose for which the loans are being raised and to facilitate their participation in the development programme on the largest possible scale”.

The volume of market borrowing by the Government is dependent upon the statutory liquidity ratio of bank investment in the securities of the government and the relevant provisions, which governs the deployment of funds in such securities by the institutional subscribers.

Small Savings - under the conditions prevalent in the economy, there is a need for paying special attention to small savings. This source has many advantages for e.g. it encourages thrift on the part of the people, restricts their
consumption and thereby helps in arresting price rise. It occupies a special place particularly in the Indian context because ours is an inflation biased economy.

External Assistance

If the efforts to mobilize domestic resources through taxation, public borrowings and deficit financing are not sufficient to finance plan outlay, the Government has to depend upon external assistance. It is a means to bridge the gap between internal sources and plan outlay, like any other developing economy, India has been a capital poor country due to its low saving and low investing capacities. Other than supplementing domestic resources foreign aid helps in industrialization in building up economic overhead capital and in creating larger employment opportunities. It not only brings money and machines but also technical know-how. It opens new avenues and exploits untapped and hidden resources. It removes the balance of payments problem and minimizes the inflationary pressures. Further foreign aid helps in modernizing the backward society in strengthening both the private and the public sector.

Public Enterprises - It is another source for financing the five year plans. With the passage of time the public sector has come to occupy an increasingly important place in the Indian economy. Organizationally there are four types of public sector enterprises
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i) Departmentally managed
ii) Managed by independent boards
iii) Run as public corporations
iv) Organized as company

"The scope of state enterprises in the industrial field was very limited in British India. Even after independence, there was no clear cut policy in respect of the role of the state enterprises. It was only in December, 1954 when socialist pattern of society came to be accepted as the goal of economic policy that increasing emphasis came to be laid on the role of the public enterprises to promote economic growth and development, promote self reliance in strategic sectors and diversify the economy, help in preventing concentration of economic power, reduce regional and social imbalances and effect equitable distribution of income through social over head capital".

The surplus of public enterprises also can make significant contributions towards mobilizing resources for development programme. In several countries public enterprises constitute a growing and potentially important source of public revenue. Besides, one of the objectives of the directive principle of the Indian constitution is to bring about reduction of the inequalities of income and wealth and to establish an egalitarian society, the five year plans have taken this up as a major objective of planning. The public enterprises too may be used for the purpose of
reduction of inequalities of income and a better distribution of income in several ways. The public enterprises contribute to the central exchequer through the payment of i) Dividend (ii) Corporate taxes and (iii) Excise duty.

Deficit Financing - Broadly speaking deficit financing is a technique that enables the Government to incur expenditure beyond its current revenue. This income is possible through the issue of additional currency.

If domestic borrowing and taxation are not enough, the Government in a developing economy usually goes with their programme of capital formation by bidding away resources from the consumer goods sector by deficit financing, inflationary deficit financing programme has the advantage that with a rising trend in the price level, the profit of the manufacturers and traders show a rising tendency if the profit is invested and saved in soundlines then the process of economic development is done almost automatically. Moreover a rise in price itself may lead to forced savings to some extent. It is the only method of financing development in a developing country and is regarded as a necessary and healthy corrective step in an economy, which is suffering from depression, deflationary condition, deficiency of effective demand or presence of idle capacity.
1.4 Review of Literature

This section presents a select of review of literature on the subject and attempts to examine the existing literature on the pattern of financing of Five year plans in India with special reference to Ninth five year Plan.

Chelliah, R.J. (1969)^ has studied the aspect of policy in less developed countries and has attempted to analyze the fundamental problems of fiscal policy in less developed countries the basic structure of public finance with emphasis on tax structure and fiscal policies, against the background of planned economic development the greater part of his work is carried on with special reference to India.

Singh, S.K. (1986)^ has examined the nature of the fiscal crisis in India and evaluated long term fiscal policy (LTFP) as a response to this crisis. The study explains that since 1975-76, the tax ratio has not kept pace with the expenditure ratio resulting in the long-term imbalance between govt. revenue and expenditure. His analysis indicates that the LTFP as a response to the challenging problem of fiscal crises has failed to offer any clear direction in two vital areas namely (i) How to restrain the increase in non-plan expenditure on revenue account and (ii) How to augment the surpluses of PSUs. Finally, he has warned that without proper advance in these areas the fiscal crises will persist.

Rakshit (1989)^ attempts to dispel the apprehension about public debt and its effects. He opines that problem of debt and its consequences have been blown out of proportion without going into serious analytical exercise. He began with listing the common perception among economists and then analyses them as to what extent these perceptions are genuine. He emphasizes the need to have a relook at the debt indices before jumping on to conclusions. He also finds fault with the practice of calculating public debt without taking into account the assets liability figure of public enterprises which would probably create positive balance in net wealth of the public Sector. It points out that most of the govt. investment is in infrastructure sector eg Roads, irrigation, communication flood control etc. which certainly enhances the production capabilities of the economy and the private sector is benefited more. It is the failure of tax machinery that it is unable to raise the tax GDR ratio in the same proportion. It
concludes that for curing the ills of the economy focus ought to be shifted from public
debt to use of funds borrowed from public for the operation of PSEs, under utilization
of capacity in public sector, tax administration, structure of interest rate and that the
remedy designed in developed countries, where the role of public debt in attaining a
higher growth rate is not paid any significant attention is just unsuitable in India’s
context.

Mundle; S and M. Govind Rao (1992) have analysed the nature of fiscal crises in
India in 1990 and related issues in the growth and composition of public expenditure,
the tax revenues and non-tax revenues. They have shown that the fiscal imbalances
were mainly a reflection of the increasing gap between revenue receipts and revenue
expenditure. There was a spurt in spending mainly on account of interest payments,
subsidies plan and non-plan grants to state governments, defense and failure of public
sector under takings etc. On the other hand the growth of tax and non-tax revenue was
not taking place. Finally they have endorsed the fiscal stabilization measures initiated in

Buiter W.H, and Patel, U. (1992) found the state of Indian public finance to be
perilous. They observed the rising trend in public debt as a ratio to GNP and also in
monetized deficit. This disturbing trend as they find, started in 1970s but accelerated
significantly in 1980s’. They also make it clear that this deterioration cannot be
explained in terms of some external shock like OPEC I and OPEC II (When oil prices
increased substantially in early 1970s and late 1970s) and the 1990 Iraqi occupation of
Kuwait and the subsequent war. They blame the public sector for the crises.

Gulati, IS. (1993) has dealt with some issues concerning the growing burden of
internal public debt in India. These questions have lately been raised with a stridency
not noticed before on reducing the fiscal deficit a term that hardly ever figured in the
lexicon of fiscal policy in India.

Mundle, S. and Hiranya Mukhopadhya (1993) in their study have analysed the
impact of alternative fiscal policies on macro-economic performance of the Indian
Economy. The most important lesson that emerged from their work is that in reducing
the deficit, greater revenue mobilization would be preferable to expenditure
compression. This should be attempted through tax-reforms rather that raising taxes.
There are however limits to how far tax reform can raise the buoyancy of tax revenue. Hence fiscal correction will have to depend in part on public expenditure compression. They have shown that in the post reform period public expenditure on almost all items except interest payment have been cut in real terms. However the sharpest cuts have fallen on those items of expenditure which ought to be protected.

Taylor, L (1993)\(^6\) has attempted to study fiscal policy issues that arise during macro-economic stabilization in developing countries. His work is based on the study of stabilization episodes in eighteen countries. He observed that the effects of fiscal stabilization and adjustment on income distribution are less clear cut and stabilization programmes should take into account specific country condition.

Tanzi U. (1993)\(^7\) has observed that fiscal reform has proven difficult to implement for political, institutional and conceptual reasons. In his work he has discussed the determination of the correct size of the fiscal adjustment needed, the problems in measuring fiscal disequilibrium, the desired fiscal measures and the sequencing of the required fiscal reforms. Finally, he argues that fiscal reforms require time to be successful.

Thirsk, W.R. (1993)\(^8\) has observed that many countries have overhauled their tax systems during the first decade. His work reviews the profile of a typical developing countries tax system prior to the recent wave of reforms.

De Melo, Martha (1993)\(^9\) has proposed the use of a sustainable deficit concept to estimate the minimum fiscal adjustment required in a high debt country. The sustainable deficit is defined to be compatible with a sustainable debt, which the borrower is willing and able to service. His work provides empirical estimates of the need for fiscal adjustment in a small group of high debt countries in the mid 1980s\(^9\).

Chibber, A and Mansoor Dailame (1993)\(^10\) argue for a need for a broader approach to the relationship between fiscal policy and private investment in developing countries such an approach needs to emphasize the role of fiscal policy and stabilization, the competitiveness between public and private investment and the taxation of income from capital. While these issues have long been recognized in the literature in the context of both developed and developing countries they have assumed
particular urgency and importance in the context of ongoing liberalization and privatization trends evident in most developing areas.

Rangarajan, Basu and Jaddav (1994) examined the dynamic behaviours of public debt ratio in India. The study undertook the exercise of construction of data base as the government measures of deficit and debt are only accounting measures which do not serve the purpose of analytically meaningful study. It for example mentioned that deficits are financed both by RBI and other than RBI Sources, and from the view point of macro-economic analysis both have different implications and hence deserve to be treated separately. It attempts to derive analytically more meaningful measure of domestic debt and when proposed method has been used to measure the expansion of domestic debt it turned out to be much larger than the conventional measure of debt used to indicate.

Shand, Ric and K.P. Kalirajan (1994) in their study indicated that the reform implemented in India since 1991-92 has been yielding positive results. Though the reform process has been gradual it is becoming increasingly clear that sustainability is not in question. The study concludes that Indian economy may be developing as a new paradigm of growth which could be relevant to other developed countries with similar structural linkages.

Bhattacharya, B.B. (1995) in his work has shown that the basic problem of fiscal stabilization in India was that the Govt. expenditure was rising faster than the Govt. income. As a result all the measures of deficit such as fiscal deficit, revenue deficit primary deficit etc has rising trends. Finally he suggested that the fiscal deficit should be reduced by slowing down growth of non-plan and wasteful expenditures on the one hand and improving direct tax revenue and surplus of public enterprises on the other.

Ghosh, A and R.K. Sen (1995) have observed in their study that during 1990s not only revenue receipts have been rather inelastic but the expenditure accounts particularly of the non-plan outlays have also gone up quite rapidly. This has been termed by them as the main cause of the fiscal imbalance. They have also suggested that it requires to be attended with policies to reduce the non-plan expenditure drastically.
Rao, M.G. Tapas, K. Sen and M. Ghosh (1995) have analyzed in their study that after 1980-81 expenditure growth was higher than that of revenue receipts. Growth of revenue expenditure was particularly sharp in the case of interest payments. Subsidies, wages and salaries with those on maintenance of capital assets lagged behind.

Nayak, P.B. (1995)*, in his work has revealed that Govt. expenditure had been far outpacing revenues for more than a decade leading the government to resort to substantial borrowing both internal and external. As a result interest payment became largest expenditure head of the Central Govt. Budget. He has also observed that the tax to GDP ratio is already reasonably high and the prospect of having it increased further appears to be limited at least in the short run so there is not much choice left and expenditure have to be cut in several vital areas.

Chakraborty P. (1997)** has attempted to examine whether the lowering the rates of direct and Indirect taxes in recent years, have resulted in higher tax mobilization the study concludes that compared to Indirect taxes, direct taxes were more buoyant during the post-reform period.

Mohan R. (2001) has analysed trends in state and Central Govt. revenues and expenditures and suggested ways to climb out of debt-trap. The key objective of fiscal reform has to be a reduction in public debt service.

Kopits, G. (2001)** assesses the potential usefulness of fiscal policy rules for India in the light of rapidly growing international experience in this area. As part of his assessment, he explores various design options and institutional arrangement that is seen as relevant for India in the context of the fiscal responsibility and Budget management Bill. He also outlines preparatory steps for successful implementation.

After reviewing the literature we can say that there is a wide agreement among economists that the problem of fiscal imbalance in many developing countries and particularity in India has emerged in the 1980s and the factors responsible for the worsening of fiscal crises were almost the same in all the developing countries.
1.5 Hypothesis

The study is based on the following hypothesis: Inadequate financing is the major constraint in achieving the objectives of Five Year Plans.

1.6 Objectives of the Study

To test the said hypothesis the main objectives of the study are as follows:

1. To examine the pattern of financing of the Five Year Plans.
2. To analyse the constraints associated with the raising of adequate resources for achievement of the objectives of the Plans.

1.7 Data Base and Methodology

Our study is based exclusively on secondary data which are published mainly by the Ministry of Finance, Government of India, other departments/offices of the Government of India and Reserve Bank of
India. Thus, most of the relevant data have been taken from various issues of Indian Public Finance Statistics, Economic Survey and the various Five Year Plan Documents. The methodology used is simple, analytical and does not go beyond calculation of percentages and arithmetical averages and to know the level of Consistency in the behaviors of leading economic indicator / parameters, standard deviations and coefficient of variation have been calculated

1.8 Outline of the chapters

The present research work is divided in Seven Chapters. The First chapter primarily deals with a brief introduction on planning and its general significance, it also includes the relevance of the theme in the context of India's financial structure. Apart from these, objective, Hypothesis, Database and Methodology have been taken into account as well as the chapter Scheme. The Second Chapter covers the background of the theoretical framework followed by the General constraints in the raising of adequate resources from expected sources. This chapter also includes the from expected sources. This chapter also includes the relative merits and demerits of each source and the comparison between plan and non-plan expenditure.

The Third Chapter of the present work review the plan by plan financing since the First Five Year Plan and its impact in the context of Indian economy and also includes
the optimum combination of sources for economic development.

The Fourth Chapter is related with the Ninth Five Year Plan and the changing scenario. In this chapter we underline the strategy and objectives of the Ninth Five Year Plan this chapter also concentrates on the impact of the new economic policies, since its inception on the economic development in the context of major dimensions of state policy.

The Fifth Chapter of the research work presents a review of the Mid-Term Appraisal of the Ninth Five Year Plan and the constraints associated with the choice of the optimum combination of sources of finance.

The Sixth Chapter of the research work will review the General impact of the pattern of the burden of economic development on different classes of the people and the economy as a whole.

Chapter Seventh presents summary, conclusions and recommendations having policy implications.
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