Chapter - 1
INTRODUCTION

1.1 CONCEPT OF FISCAL POLICY

There are two major types of policies which the government can adopt to influence the level of economic activity: fiscal policy and monetary policy. Fiscal policy refers to changes in government spending and taxation including debt-management. Monetary policy is mainly conducted through measures designed to influence the money supply or the level of interest rates. There is considerable overlap between the two policies. A change in fiscal policy affects the monetary side of the economy and this in turn affects the results of the original change in fiscal policy.

Before we proceed our discussion further, it would be rewarding to have a brief background of the evolution of the idea and philosophy of fiscal policy.

Though the concept of fiscal policy emerged only after the Keynesian revolution in economics, its basic philosophy can be traced to the eighteenth century. However, the scope of government economic activity widened substantially only during and after the Great Depression of 1930s. During this period, the role of the government in maintaining economic stability came to be theoretically as well as politically justified and this role was found to be in harmony with achieving growth of national output and reduction of economic inequalities. During the post war years, the scope of the role of government further widened particularly in the developing countries in the context of the need for government economic
planning for achieving rapid economic development. As a result of all these additional responsibilities, the governments in the developing countries have been called upon to defend their borders, maintain law and order, provide necessary social and economic infrastructure facilities, maintain economic stability, promote economic development, effect redistribution of income and wealth, function as entrepreneurs and promote consequential social objectives.

'The fiscal operations of the government for promoting the economic development of the less developed countries are as an investor, as a stabiliser, as a saver and as an income redistributor'.

Thus, it may be observed that fiscal policy which emerged as a branch of applied economics under the name of macro-economic analysis has grown in its coverage. And today it is very difficult to say that fiscal policy covers only macro-economic policy at least with reference to a developing economy like India. Fiscal policy in developing countries involves a judicious mixture of macro-economic policies of the government to achieve multiple objectives.

The government in modern democracies discharges the above mentioned various and varied socio-economic responsibilities mostly through the instrumentality of its budget. The budget includes an annual estimate of expenditure to be incurred, expected revenue, borrowing and debt repayment with a view to achieving explicit objectives of the government. In order to be effective in achieving these objectives, the budgetary instruments namely, taxation, borrowing, lending, spending and
transfer payments should influence the national economy through the major economic variables such as levels and rate of growth of income, consumption, prices, balance of payments etc. both at aggregate and sectoral and micro levels. When these economic variables are influenced by the national budget, they in turn influence various components of the budget through the change in their levels, rates of growth and direction. The influence of the budget on the national economy is mainly deliberate as various budget instruments are altered so as to alter significant variables. However, a well designed fiscal policy may also influence the economy automatically during the interval between two budget periods or policy decisions. This is known as the 'built-in-flexibility' of fiscal measures. Similarly, the economy after being influenced by the budgetary policies experiences significant changes in terms of major economic variables of the economy such as income, consumption, price, etc., but also gets the automatic responses through the level of expenditure, etc. In this way the national fiscal policy and the national economy interact mutually. But the main objective of fiscal policy is to influence national economy in the desired direction rather than being influenced by it.

Fiscal policies are required if society desires to alter the distribution of output between government and private uses. This is a special case of the general choice between consumption, private investment and government expenditure. The problem of dividing output correctly for final use is a matter of efficient allocation of resources and the solution depends on the preferences of society. Fiscal policies are also required to promote equity in the distribution of income and wealth.
Volatile disturbances distribute the income and capital losses from inflation or unemployment in a haphazard manner which is contrary to society's expenditures are the only feasible methods available for mitigating the haphazard incidence of misfortune. Efficiency and equity considerations require that fiscal policies form an important role in the formulation of economic policies.

1.2 PROBLEM OF FISCAL STABILIZATION

As we have explained earlier, the role of the government has to be extended to a vast variety of fields and today the objectives of fiscal policy have multiplied. For example, during the days of Laissez-faire philosophy when the government was confined to the limited area, the main objective of taxation was to raise revenue adequate enough to meet the minimum requirements the 'police state' functions. But subsequently when the role of government got extended to economic development, the role of taxation has to be identified with raising resources or diversion of increased income from the private sector to the public sector for increasing total savings. Similarly, the role of public expenditure which was confined only to providing essential public service has been extended to the sphere of social security, old age pension and the like plus public sector investment for maintaining economic stability as well as promoting economic development in developing countries. Public debt policy which was intended to be used in emergencies like war has come to be justified for the purpose of maintaining economic stability and subsequently it has been extended to the area of economic development. These consequential
extensions and expansions in the field of taxation, public expenditure and public borrowing have caused the size of the government budget in the democracy to increase very fast. Adolf Wagner hypothesized that as economic development proceeds in a smooth linear line, the demand for 'public goods' will increase and as a result the government expenditure will increase faster than the national output. But the government expenditure has increased even during the period of economic stagnation. Now, we can say that these trends led the economy towards fiscal imbalance.

During the past two decades stagnant revenues along with difficulties in compressing public expenditures, resulted in high deficit in many developing countries. With foreign borrowings fore-closed, government were left with no choice except domestic source of financing or market borrowings. The ensuing increase in money supply could only result in runaway inflation. Excessive reliance on borrowings have pushed a number of economies into debt-trap. Problem of fiscal stabilization further worsened due to all these factors, and a vicious circle of fiscal imbalance has emerged.

1.3 NATURE OF THE PROBLEM IN INDIAN ECONOMY

It is now widely agreed that the Indian economy was undergoing a severe crisis by the end of the 1980s. The crisis was possibly the severest that the country has had to face in the post-independence era. The fiscal sector of the economy was possibly in the throes of its most stringent test ever. The foreign trade sector of the economy was in great
trouble. In the fiscal sector government expenditures were outpacing revenues in the current account for more than a decade leading the government to resort to substantial borrowings. The public debt had reached to such a level that interest payments constitute the largest single expenditure head of the central government. Non-essential expenditure continues to grow unabated, the explanation for which can not be confined to strictly economic factors.

All of the trends noted above have been the wages of a soft state where government expenditures have bloated way out of proportion to tax and non-tax revenues. Faced with a resource crunch, when budgetary allocations have had to be trimmed, it has invariably been capital that has had to be axed, while revenue expenditure has gone on expanding. Powerful vested interests have emerged to keep the fiscal economy running in this manner.

The implications of the above trends on the monetary sector were immediate. Alongwith the large revenue deficits the central government has had large budget deficits averaging about 2.5 per cent of GDP during the seventh plan period. This in turn has contributed to a large monetised deficit. It is this which determines the growth of money supply. Money supply grew at an average annual rate of over 17 per cent during the seventh plan period, causing a substantial liquidity overhang in the economy. This contributed in a large measure to the double digit increase in the inflation that the economy went through during 1990-91.

The fiscal situation, which had been under mounting pressure throughout 1980s, assumed crisis proportions by the begining of the
1991-92. The gulf war exacerbated the already precarious fiscal situation. At a macro-economic level, fiscal deficits, besides contributing to inflationary pressures, have also been seriously spilling into balance of payments.

Throughout the eighties, all the important indicators of fiscal imbalance were on the rise. These are the budgetary deficit, the revenue deficit, the monetised deficit and gross fiscal deficit. Such a fiscal situation has become unsustainable. Evidently, a stabilization programme reversing the growth in the budget deficit and tightening monetary policy was called for.

1.4 PROBLEMS IN THE MEASUREMENT OF FISCAL IMBALANCE

The correct measurement of the fiscal imbalance is fraught with formidable difficulties. These difficulties have been often ignored by economists. The commonly used measures of the fiscal deficit can be highly inadequate. They may not be comparable over time. And they are often imprecise gauges for determining the size of the needed fiscal correction. The difficulties are several.

The first difficulty is connected with the quality of the data. With few exceptions, governments have not given a high priority to the gathering and provision of reliable and up-to-date statistics. In fact, governments have shown little interest in improving the quality of the fiscal data.

The second issue concerns the comprehensiveness of the available fiscal data. The central government, which is often the main actor
and the centre of attention in stabilization programmes, represents in many countries, only a limited part of the public sector. The whole public sector is compartmentalized into the central government, state governments and municipalities, public enterprises, the central bank, stabilization funds, various forms of extra budgetary accounts including social security, and so forth. These compartments are often interconnected and some sort of implicit transfer prices are used to determine the scope of financial or resource flows among them. These transfer prices often do not reflect market prices. The public enterprises may sell services to the central government at below market prices or they can borrow to reduce transfers from the central government. All these examples mean that in many cases the fiscal deficit can be 'parked' in compartments of the public sector where it can be least embarrassing politically or where it can be financed most easily in the short run.ii

To avoid this problem, the data on which the fiscal stabilization should be based must be comprehensive enough to encompass the whole or much of the public sector. But this is extremely difficult or may even prove impossible because the information required is often not available, or if it is available, it is not up-to-date. This limitation may create serious difficulties in the conduct of fiscal policy. For example, a programme that emphasized a reduction in the fiscal deficit of the central government might encourage maneuvers to push the deficit out of the central government into the state governments etc.

Some of these problems often arise out of the fact that the fiscal deficit, as conventionally measured (i.e. total expenditure less ordinary
revenues), is highly sensitive to the rate of inflation and to the exchange rate.

In the presence of domestic debt, inflation can bring about dramatic changes in the size of the fiscal deficit by increasing nominal interest rates and thus nominal interest payments. In such situations it ceases to provide useful measure of the size of the fiscal correction needed by the stabilization programme. Other definitions of the fiscal deficit have been introduced in recent years and are often used in stabilization programmes. One such concept is the operational deficit which seeks to remove from total expenditure the part of interest payments, that is considered a 'monetary correction'. The practical measurement of the operational deficit is very difficult and its theoretical underpinnings are controversial. Therefore, this concept, though useful, must be treated with caution.

The primary deficit which excludes all interest payments from the measurement of the deficit, is a tool more useful in assessing the size of an adjustment. The primary deficit or rather the primary surplus is useful in providing an indication of the amount of current resources available to a government to service its public debt. It has limited value in indicating what the fiscal correction should be.

Timing issues also create difficulties. A deficit can be measured on the basis of cash flows (i.e. actual cash receipts and payments) or it can be measured on a commitment basis for expenditure and on an actual basis for revenues. When arrears are increasing, an adjustment programme
which employs the cash concept may miss the pressures on resources and on demand associated with expenditures made but not yet paid for.

1.5 FISCAL AND BUDGETARY DEFICITS: SOME DEFINITION AND ISSUES

In recent years the official documents have listed the following concepts of deficits in the government accounts.

(1) RD (Revenue Deficit) = Revenue Expenditure - Revenue Receipts.

(2) BD (Budget Deficit) = Total expenditure - Total Receipts (excluding net sale of treasury bills).

(3) DF (Deficit Financing) = Increase in net RBI credit to the government.

(4) FD (Fiscal Deficit) = Total expenditure - (Revenue receipts + Recovery of loans + Receipts from the sale of assets).

(5) DCA (Deficit on Capital Account) = Capital Expenditure - Capital Receipts (excluding net sale of treasury bills).

(6) PD (Primary Deficit) = Fiscal Deficit - Interest Payments

RD is the deficit generated through current transactions in the budget and denotes the dissaving of government administration and defence. BD as noted in (2), indicates the amount of government expenditure financed through net sale of treasury bills during the financial year (irrespective of who buys these bills). DF gives the net increase in the RBI holding of treasury bills plus other government securities less
increase in government deposits with the Reserve Bank. FD constitutes the increase in gross indebtedness of government administration and defence to the rest of the economy (or the world). It follows from the earlier relations that DCA is the sum of net sale of treasury bills less the revenue deficit of the government. PD stands for gross borrowings of the government required to meet all expenditure less interest payments.

The relevance or the usefulness of these various concepts of deficits depends on the purpose at hand and on the extent they can be manipulated by the government for attaining its economic objectives. From the viewpoint of economic analysis and policy prescription, our focus has to be on the significance of these deficits for the generation of aggregate demand or inflationary pressures; for the overall saving ratio or economic growth, for the transfer of resources between the private and the public sectors, and for the sustainability of public debt or the solvency of the government.

1.6 REVIEW OF LITERATURE

Before embarking upon a research project it is absolutely essential to review the literature on the same or similar subject. Keeping this in mind an effort has been made here to review some of the existing literature on fiscal stabilization.

Chelliah, R.J. (1969)\(^2\) in his study of fiscal policy in less developed countries attempts to analyse 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. He has also observed that the fiscal policy appropriate for a country will depend, apart from many other factors, on the stage of its development and on the social grounds.

Musgrave, R.A. (1969) in his study of fiscal systems has examined the essential characteristics of fiscal systems in the context of certain key features of economic life. His study deals with the adaptation of fiscal systems to the requirements of centrally planned and decentralized or market economies. He also examined the interaction between fiscal systems and economic development and compared the tax structure of a number of highly developed countries. In his study he also raised the issues like fiscal centralization versus decentralization, the formulation of the budget plan, the impact of governmental forms on fiscal behaviour, social security and transfer systems, and the structure and management of public debt.

Gowda, K.V. (1987) in his work has criticized the long term fiscal policy (LTFP) that it has placed exclusive reliance not on fiscal policy with all its various segments. For it does not touch on expenditure policy, monetary policy, debt management and international economic policy but on tax policy. In his study he explains how fiscal policy instruments are to be integrated with all other instruments of macro-economic policy in order to realise the desired results and underlines the complications of pursuing fiscal policy in isolation.
Singh, S.K. (1988)\(^5\) has examined the nature of the fiscal crisis in India and evaluated long term fiscal policy 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 government revenues and expenditures. This gap which widened during the sixth plan became much larger during the seventh plan. Thus the central government has to borrow even to meet its current expenditure. His analysis indicates that the LTFP, as a response to the challenging problem of fiscal crisis, 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 crisis will persist.

Rakshit, M. (1991)\(^6\) in his work has studied the fiscal roots of macro-economic imbalance in India, and found that during 1980s, fiscal imbalance assumed alarming proportions due to widening gap between revenue and expenditure. In his work he has discussed macro-economic adjustment programme introduced by the government to resolve the fiscal crisis. Finally, he raises a number of important issues regarding viability of fiscal management.

Mundle, S. and M. Govinda Rao (1992)\(^7\) have analysed the nature of fiscal crisis in India in 1990 and related issues in the growth and composition of public expenditure, the tax system and mobilisation of tax revenues and non-tax revenues. They have shown that the fiscal imbalance
was 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, defence and failure of public sector undertakings etc., on the other hand, the growth of tax and non-tax revenues was stagnated. Finally, they have endorsed the fiscal stabilization measures initiated in 1991.

Chhibber, A. and Mansoor Dailami (1993) argues 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 recognised in the literature in the context of both developed and developing countries, they have assumed particular urgency and importance in the context of the ongoing liberalization and privatization trends evident in most developing countries.

Cornia, G.A. and F. Stewart (1993) reviews changes in the fiscal policy of developing countries undergoing economic adjustment during the 1980s. Macro-choices in the areas of overall taxation, government expenditure and fiscal deficit are first examined. It appears that although a few countries managed to combine raising government expenditure per head and a falling budget deficit thanks to increases in tax ratio and/or to overall growth, in the majority of the countries analysed, traditional fiscal
policy emphasizing rapid reductions in budget deficits through expenditure reductions compounded the negative effects of falling incomes on the welfare of the poor. Finally, they conclude that the main elements of fiscal policy approach are aiming at protecting the poor during adjustment.

de Melo, Martha (1993)\textsuperscript{10} 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. Their experience is compared to that of a small group of low debt countries, to distinguish the differences in the adjustment requirement and its determinants during this period. The results illustrate the extent to which the appropriate size of the fiscal deficit depends on the macroeconomic context.

Faini, Riccardo and Jaime de Melo (1993)\textsuperscript{11} takes a look at the evidence of fiscal adjustment in developing countries. They found that, while on an average, developing countries were successful after 1985 in cutting their primary deficits, rising interest costs and stagnant fiscal revenues implied limited progress towards reducing fiscal imbalances. Most of the improvement on the fiscal front was achieved by cuts in capital expenditures. Then they have focussed on issues such as the size of fiscal adjustment, the macroeconomic impact of deficit reduction and the choice between expenditure cuts and tax increases.

Gulati, I.S. (1993)\textsuperscript{12} has dealt with some questions concerning the growing burden of internal public debt in India. These questions that
have lately been raised with a stridency not noticed before focus on reducing the fiscal deficit, a term that hardly ever figured in the lexicon of fiscal policy in India.

Kapila, U. (1993)\textsuperscript{13} in her analysis of public finances of India has shown that the fiscal situation which was under strain throughout the 1980s, reached a critical situation in 1990-91. Throughout the eighties, all the indicators of fiscal imbalance were on the rise. The unabated growth of non-plan expenditure and poor returns from investments made in the public sector have been the main contributory factor in the fiscal crisis. Government initiated the fiscal stabilization and intended to continue it. She has also suggested that for the realisation of the fiscal stabilization, it is imperative to restrain the rise of expenditures. Fiscal discipline is also necessary on the part of PSEs to hasten the process of fiscal correction.

Mookherjee, D. (1993)\textsuperscript{14} has analysed the fiscal stabilization reforms in the Indian economy. In this work he has highlighted that at the turn of the eighties into the nineties, serious action on the fiscal front was urgently needed to correct the macro-economic imbalances. The principle instruments of fiscal stabilization in 1991-92 were plan expenditure and subsidies on exports and fertilisers. Disinvestment of equity holding in central public sector enterprises also provided a cushion. Initially government succeeded in its determined effort at fiscal stabilization and brought the fiscal deficit down.

Mundle, S. and Hiranya Mukhopadhyay (1993)\textsuperscript{15} in their study
have analysed the impact of alternative fiscal policies on macro-economic performance of the Indian economy. The most important lesson emerged from their work is that in reducing the deficit, greater revenue mobilisation would be preferable to expenditure compression. This should be attempted through tax reforms rather than raising rates. There are, however, limits to how far tax reforms 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 payments have been cut in real terms. However, the sharpest cuts have fallen on those items of expenditure which ought to be protected.

Tanzi, V. (1993)\textsuperscript{16} 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 reform require time to be successful.

Taylor, L. (1993)\textsuperscript{17} has attempted to study fiscal policy issues that arise during macroeconomic stabilization in developing countries. His work is based on the study of stabilization episodes in eighteen countries. He has 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 conditions.

Thirsk, W.R. (1993)\textsuperscript{18} has observed that many countries have
overhauled their tax systems during the past decade. His work reviews the profile of a typical developing country tax system prior to the recent wave of reforms. A detailed description of tax reforms in several developing countries is presented. Comparison across countries indicate an emerging consensus on the desirable characteristics of a tax system: neutrality and the adoption of a more uniform system of taxation, the progressive abandonment of special tax distinctions and exemptions and simpler tax designs.

Shand, Ric and K.P. Kalirajan (1994) in their study indicated that the reforms implemented in India since 1991-92 have been yielding the anticipated 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 evolving a new paradigm of growth which could be relevant to other developing countries with similar structural linkages.

Bhattacharya, B.B. (1995) in his work has evaluated the factors responsible for fiscal imbalance in 1990 and analysed the performance of fiscal stabilization measures. He has shown that the basic problem of the fiscal stabilization in India was that the government expenditure was rising faster than the government income. As a result all the measures of deficit such as fiscal deficit, revenue deficit, primary deficit etc. have 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.

Datta, R. and R.K. Sen (1995)\textsuperscript{21} have shown in their study that in India, the budgetary and fiscal deficits of the central government had been growing significantly during the sixth and seventh plan periods. They have cautioned that in the process of enforcing fiscal discipline and aiming at fiscal stabilization. Contrary steps should be avoided not only in the policy packages but also in the measures adopted at the central and state levels.

Ghosh, A. and R.K. Sen (1995)\textsuperscript{22} have observed in their study that during 1980s not only the 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.

Nayak, P.B. (1995)\textsuperscript{23} in his work has revealed that in the fiscal sector, government expenditure had been far outpacing revenues for more than a decade, leading the government to resort to substantial borrowings, both internal and external. As a result interest payments become largest expenditure head of the central government budget. Non-essential expenditure continues to grow unabated. 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 expenditures have to be cut in several vital areas.
Rao, M.G., Tapas, K. Sen and M. Ghosh (1995) have analysed in their study that after 1980-81, expenditure growth was higher than that of revenue receipts. Within total expenditure, revenue expenditure grew at rates higher than that of capital expenditure. Growth of revenue expenditure was particularly sharp in the case of interest payments, subsidies, wages and salaries, while those on maintenance of capital assets lagged behind. So fiscal imbalance becomes inevitable by the end of 1980s. The analysis also points towards the difficulty in achieving fiscal equilibrium in the short and medium term context. So long as the interest groups succeed in securing a large and increasing share of expenditures on categories beneficial to them, compression of fiscal deficit become difficult.

Chakraborty, P. (1997) has attempted to examine whether the lowering the rates of direct and indirect taxes in recent years has resulted in higher tax mobilisation. The study concludes that compared to indirect taxes, direct taxes were more buoyant during the post-reform period. It has been observed by the author that generally reduction in tax rate cannot make a tax more buoyant instantly. There is a time lag involved.

Shome, P. (1998) attempts to assess the state of fiscal stabilization in the post-reform period. He has shown that after an initial improvement in the fiscal deficit, the government faced difficulty in controlling the fiscal deficit/GDP ratio. The tax/GDP ratio also declined and the central government passed down certain expenditure responsibilities to state governments, thereby managing to reduce the expenditure/GDP ratio to some extent. His work focusses on the
performance of the fiscal sector and the direction for future policy imperatives.

Mohan, R. (2000)\(^\text{27}\) has analysed trends in state and central government revenues and expenditures and suggested ways to climb out of debt trap. He has observed that rapid economic growth is the only solution to the problem of poverty and such growth is not possible without significant fiscal correction. The key objective of fiscal reform has to be a reduction in public debt service payments.

Kopits, G. (2001)\(^\text{28}\) 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 arrangements that seem 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 wide agreement among economists that the problem of fiscal imbalance in many developing countries and particularly in India has emerged in the 1980s. And the factors responsible for the worsening of fiscal crisis were almost same in all of the developing countries. For example run-away expenditure coupled with stagnant revenues (along with lower share of direct taxes) and growing public debt with rising amount of interest payments.

1.7 OBJECTIVES OF THE STUDY

The objectives of this study are:
(i) to study the conceptual framework and the basic issues involved in the problem of fiscal stabilization,

(ii) to examine the background and causes of the inception of the problem,

(iii) to study the measures undertaken by the government for the restoration of fiscal stabilization,

(iv) to review the impact of the fiscal stabilization measures in the different dimensions, and

(v) to identify areas for further reform to restore sustainable fiscal stability.

1.8 SCOPE AND LIMITATIONS OF THE STUDY

The choice of the seventh plan or 1985-86 as starting point of the present study, is basically because problem of fiscal imbalance started worsening from this period. In the Indian economy a number of events took place during eighties and by the end of eighties the problem of fiscal stabilization reached to a dangerous level. This situation compelled the government of India to take some bold steps to restore fiscal stability in the economy. These events generated interest among the students of public finance to study the whole problem with a new approach.

It may be noted that 'Problem of fiscal stabilization' constitute a vast and dynamic field of the study. Scope of any study specially in social sciences is always limited and our work is not an exception. We have tried not to capture each and every factor rather concentrated on few selected
factors. Therefore, despite all efforts to make this study up-to-date, comprehensive and analytical deficiencies are bound to remain.

1.9 DATABASE 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 RBI. Thus, most of the relevant data have been taken from various issues of Indian Public Finance Statistics', 'Economic Survey', 'National Accounts Statistics', 'Budget at a Glance', and 'Report on Currency and Finance'. Besides these sources we have also taken data from 'Public Finance Statistics' published by CMIE, Mumbai and 'Economic Development in India - A country report, published by the World Bank.

The methodology used here in order to identify and analyse the important factors which have contributed to the occurrence of the fiscal instability, does not go beyond simple statistical methods.

1.10 PLAN OF THE STUDY

The study is divided into six sections: In section 1, we have dealt with the Introduction of the study. This chapter covers the concept of fiscal policy and nature of the problem of fiscal stabilization. After that, survey of relevant literature has been undertaken. Second section is devoted to the conceptual framework and basic issues in fiscal stabilization. Causes of the problem, size of the deficit and quality of the fiscal stabilization measures have been discussed in this chapter. Section
three covers problem of fiscal stabilization during the seventh plan period. Various tools of fiscal policy have been analysed in this chapter in order to identify the factors responsible for fiscal instability in the Indian economy. Section four attempts to review fiscal stabilization measures introduced by the government of India since 1991. In section five, effect of fiscal stabilization measures on the performance of various fiscal tools have been analysed. Finally, in section six, conclusions drawn from the study are made and some suggestions have also been put forward.
NOTES


ii) Shifts of the deficit among different sections of the public sector can create difficulties in assessing the progress of fiscal stabilization programmes through the monitoring of fiscal ceilings.

iii) It requires a full estimate of domestic debt, a precise measurement of the rate of inflation, the assumption that expected inflation is equal to measured inflation and so forth.
REFERENCES


