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IMPACT OF FISCAL RESPONSIBILITY LEGISLATIONS ON FISCAL DEFICITS

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Abstract

Fiscal deficit is a more comprehensive indicator of the Government's deficit, which may be advantageous to an economy if it creates new capital assets that increase productive capacity and generate future income stream. On the contrary, it is detrimental for the economy if it is used just to cover revenue deficit as it results in debt traps, inflationary pressure, partial use, retards future growth etc.Realizing the importance of the containment of fiscal deficits, the Central and State Governments have implemented the Fiscal Responsibility Legislations (FRLs)in India.The study covers an examination of the impact of FRLson Fiscal Deficit i.e. to what extent fiscal deficit is contained at a sustainable levelby FRLsis studied, considering the pre and post FRL period data in the Non Special Category States in India. The statistical analysis revealed that the means of fiscal deficits to Gross State Domestic Product ratios of the select Non Special Category States are reduced during the post FRL period, compared to pre FRL period and variations of the ratios among the states are also reduced, which may indicate that the FRLs implementation had a significant impact on the containment of fiscal deficits. Hence, an effective implementation of FRLs coupled with other reforms would reduce the fiscal deficits, which may ensure the positive economic growth and human development.

***Keywords**: Fiscal, Deficit, Legislation, Containment, Period.*

Introduction

Fiscal deficit, a more comprehensive indicator of the Government's deficit, is the sum of revenue and capital expenditure less all revenue and capital receipts other than the loans taken. It is a measure of how much the Government needs to borrow from the market to meet its expenditure when its resources are inadequate. In simple words, it is the amount of borrowing that the Government has to resort to meet its expenses. It is expressed as, Fiscal Deficit = (Revenue Expenditure + Capital Expenditure) – (Revenue Receipts + Recoveries of Loans + Other Capital Receipts).

Fiscal deficit is advantageous to an economy if it creates new capital assets which increase productive capacity and generate future income stream. On the contrary, it is detrimental for the economy if it is used just to cover revenue deficit. Some of the major implications of fiscal deficit are as follows:

- **Debt Traps:** Borrowing finance by the Government to cover fiscal deficit and even interest payment may lead to the emergence of a vicious circle and debt trap.
- **Inflationary Pressure:** Fiscal deficit, consequent of wasteful and unnecessary expenditure by the Government, may create inflationary pressure in the economy, asthe Government borrows from RBI to meet it. This may result in printing of more currency notes (called deficit financing) and circulation of more money, causing to inflationary pressure in the economy.

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