Deficit Financing

'Deficit Financing' is a term that defies a satisfactory definition applicable to all countries at all times. As adopted the Planning Commission in India, deficit financing in India equals the net increase in the purchasing power of the economy arising out of budgetary operations of the government. When government expenditure is more than the income from taxes, fees and loans, the government resorts to the practice of deficit financing.

Excess of government expenditure has to be financed from some source. It can be done either by drawing down the cash balances of the government held in the Reserve Bank of India or by borrowing from the Reserve Bank. Both these methods of financing the deficit result in expanding the money supply held by the public. Thus, deficit financing means an increased spending by the government that leads to a net increase in the money supply in the market.

There are three types of situations in which deficit financing has to be resorted to. It has to be resorted to for prosecuting a war, for fighting depression and for financing economic development. Whenever there is unemployment, the government has to stimulate economic activity and development programme in order to create avenues of employment. The government's tax revenue remains the same whereas the expenditure goes up. It has to resort to deficit financing. Thus, deficit financing is used to create additional employment opportunities when the economy is suffering from a deficiency of effective demand.

Deficit financing also helps in financing productive enterprise. Previously it was thought that more money in the market was likely to produce inflation or rise in prices. But it has now been realized that it is not necessary so. As deficit financing creates more employment there is an increase in the output also. Additional supply check inflation. Thus, deficit financing can be safely used to expand income, output and employment without any dangers of inflation.

Deficit financing has a big role to play in the economic development of an under-developed country like India. The big problem with us is that population is growing at a much faster rate than the rate of capital formation. If we have to provide full employment to our labour force, we need huge amounts of capital. The economically weaker people cannot invest money from their own meager resources. The government has to help them with the money for the rapid development of the country. Economic growth can be accelerated only by increasing the rate of investments. This requires deficit financing. This is especially so in a country where the people are too poor to save any money.

The possible consequences of deficit financing are:

increase in money supply with the public

the rise in the level of income and

the rise in the general price level.

A carefully planned fiscal policy can, however, certainly control the inflationary trends to a large extent.

There is no doubt that deficit financing has its limitations. It is desirable to keep it within safe limits. It must be accompanied by a suitable fiscal policy and a proper increase in production. Any policy is useful only when it is implemented with discipline and proper planning.