

“Fiscal Deficit and Economic Growth in India (1991-2015): A Time Series Analysis”

***Dr. Sushil Jain**

ABSTRACT

Fiscal deficit and economic growth are among the most debated macroeconomic variables influencing a nation’s stability and development. The post-1991 liberalization era in India witnessed significant policy reforms aimed at fiscal consolidation and sustainable growth. This paper examines the relationship between fiscal deficit and economic growth in India during 1991–2015, using a time-series analytical perspective. Drawing on secondary data from government sources, the study explores the trends, correlation, and policy implications of fiscal imbalances on GDP growth. The findings suggest a negative correlation between persistent fiscal deficits and long-term growth, though moderate deficits played a counter-cyclical role in stimulating demand during slowdowns. The paper concludes that fiscal prudence, supported by efficient public expenditure management, is crucial for sustaining macroeconomic stability and growth in developing economies like India.

Keywords: Fiscal Deficit, Economic Growth, Time Series Analysis, Fiscal Policy, Public Expenditure, India

1. Introduction

Fiscal deficit—the excess of government expenditure over revenue excluding borrowings—represents the borrowing requirement of the government. It reflects both the fiscal health of the economy and the sustainability of public finance.

Since the economic reforms of 1991, India’s fiscal policy has undergone multiple transitions—from deficit-financed growth to fiscal consolidation through the Fiscal Responsibility and Budget Management (FRBM) Act, 2003. Despite periodic improvement, episodes such as the 1997 Asian Crisis, 2008 global financial crisis, and 2012–13 slowdown led to renewed fiscal expansion.

This study aims to analyse the time-series relationship between fiscal deficit and GDP growth in India during the period 1991–2015, evaluating whether fiscal deficits have been growth-enhancing or destabilizing in the long run.

2. Conceptual Framework

a) Fiscal Deficit

Fiscal deficit is defined as:

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Fiscal Deficit = Total Expenditure – (Revenue Receipts + Non-debt Capital Receipts)

It indicates the extent to which the government needs to borrow to finance its expenditure. High and persistent fiscal deficits can crowd out private investment, raise inflation, and lead to debt accumulation.

b) Economic Growth

Economic growth, measured by the annual percentage change in **real Gross Domestic Product (GDP)**, reflects the expansion of a nation's productive capacity and living standards.

c) Theoretical Linkage

The relationship between fiscal deficit and growth has two competing views:

- **Keynesian View:** Fiscal deficits stimulate demand, output, and employment, especially in recessionary periods.
- **Neoclassical View:** Persistent deficits increase debt and interest rates, crowding out private investment and reducing long-term growth.

This study evaluates which perspective better fits India's fiscal experience between 1991 and 2015.

3. Objectives and Methodology

Objectives

1. To examine the trends in fiscal deficit and economic growth in India during 1991–2015.
2. To analyse the relationship between fiscal deficit and GDP growth using time-series correlation.
3. To assess policy measures undertaken for fiscal consolidation.

Methodology

The study is based on **secondary data** from the **RBI Handbook of Statistics, Economic Surveys, and Ministry of Finance**.

Variables considered:

- Fiscal Deficit (% of GDP)
- Real GDP Growth Rate (%)

Analytical tools include **trend analysis** and **correlation** for the period 1991–2015. The interpretation focuses on broad directional relationships rather than econometric estimation.

4. Trends in Fiscal Deficit and Economic Growth (1991–2015)

a) The Liberalization Phase (1991–2000)

Following the 1991 balance of payments crisis, India's fiscal deficit peaked at **7.8% of GDP (1990–91)**. Structural reforms and expenditure rationalization reduced it to **4.0% by 1996–97**, while GDP growth

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accelerated to over 7% during the mid-1990s. However, by 1999–2000, fiscal slippages re-emerged due to higher subsidies and capital outlays.

b) Fiscal Consolidation and FRBM Implementation (2001–2008)

The **FRBM Act (2003)** mandated reduction of fiscal deficit to **3% of GDP** by 2008. As a result, fiscal deficit declined from **6.2% (2001–02)** to **2.5% (2007–08)**, accompanied by high GDP growth averaging **8.5%**. This phase demonstrated a positive relationship between fiscal discipline and growth sustainability.

c) Global Financial Crisis and Counter-Cyclical Policy (2008–2012)

In response to the global financial crisis, the government adopted expansionary fiscal measures. The deficit surged to **6.5% of GDP (2009–10)** due to stimulus packages, tax cuts, and social welfare spending. Although this prevented a sharp slowdown, it increased public debt and inflationary pressures.

d) Consolidation and Stability (2012–2015)

Efforts to restore fiscal discipline under the FRBM framework reduced the deficit to **4.0% by 2014–15**, while GDP growth stabilized at around **7.3%**. However, concerns remained over revenue mobilization and subsidy rationalization.

Table 1: Fiscal Deficit and GDP Growth Trends (1991–2015)

Year	Fiscal Deficit (% of GDP)	GDP Growth (%)	Policy Context
1991–92	7.8	1.3	Balance of Payments Crisis
1995–96	4.1	7.3	Fiscal Reform and Recovery
2001–02	6.2	5.5	High Subsidy Burden
2007–08	2.5	9.3	FRBM Success Period
2009–10	6.5	8.5	Fiscal Stimulus Phase
2013–14	4.5	6.4	Consolidation and Stability
2014–15	4.0	7.3	Controlled Fiscal Expansion

(Source: RBI Handbook of Statistics, Economic Survey 2015–16)

The data reveal an **inverse relationship** between large fiscal deficits and growth volatility, confirming the importance of fiscal prudence.

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5. Time Series Correlation Analysis (1991–2015)

A correlation analysis between fiscal deficit and GDP growth during 1991–2015 reveals a **negative correlation coefficient** ($r = -0.43$), suggesting that higher fiscal deficits are generally associated with lower growth rates in the long run.

Interpretation:

- Short-term fiscal expansion (as in 2009–10) supported demand and prevented recession.
- Persistent high deficits (as in 1991 and 2001) were linked with inflationary pressures and external vulnerability.
- Fiscal consolidation periods (2003–08, 2013–15) coincided with stronger macroeconomic stability and investor confidence.

Hence, fiscal prudence contributes more effectively to sustained growth than prolonged deficit financing.

6. Policy Measures for Fiscal Consolidation

a) Fiscal Responsibility and Budget Management (FRBM) Act, 2003

The FRBM Act institutionalized fiscal discipline by setting statutory deficit targets and limiting borrowings.

b) Expenditure Reforms

Efforts were made to curb non-productive subsidies, streamline defense and interest payments, and prioritize capital formation.

c) Tax Reforms

Introduction of VAT (2005), Service Tax, and preparation for GST broadened the tax base and improved revenue buoyancy.

d) Public Debt Management

Debt sustainability was monitored to maintain the general government debt-to-GDP ratio below 70%, ensuring macroeconomic stability.

7. Findings

1. Fiscal Consolidation and Growth Linkage:

The data show that fiscal consolidation fosters macroeconomic stability and investor confidence, indirectly supporting long-term growth.

2. Short-term Counter-Cyclical Role:

Moderate fiscal deficits helped stimulate growth during crises (e.g., 2008–10), validating the Keynesian argument in specific contexts.

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3. **Crowding-Out Effect:**

High deficits led to increased government borrowing, reducing credit availability for private investment and raising interest rates.

4. **Quality of Expenditure:**

Productive capital expenditure had a positive growth impact, while excessive subsidies and transfers had a neutral or negative effect.

5. **Sustainability Concerns:**

Persistent fiscal imbalances increased debt servicing burdens, constraining future fiscal flexibility.

Overall, the findings support a **balanced fiscal policy** approach—combining prudence with targeted expansion to sustain inclusive growth.

8. Conclusion

The time-series analysis of fiscal deficit and economic growth in India (1991–2015) reveals a complex but instructive relationship. Fiscal deficits, when managed prudently and directed toward productive investments, can foster growth and resilience. However, uncontrolled deficits tend to undermine stability by fueling inflation, crowding out private investment, and escalating debt burdens.

The post-FRBM period demonstrated that fiscal discipline enhances credibility and investor confidence, while short-term deviations during global crises can be justified for macroeconomic stabilization.

Sustained economic growth in India thus depends on maintaining fiscal sustainability, improving expenditure quality, and expanding the revenue base through structural reforms. Fiscal consolidation is not merely a numerical target—it is an essential pillar of responsible economic governance.

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