Q1. What is deficit financing? Is deficit financing always bad? Critically examine.

Approach

Define what is meant by deficit financing.Mention in next part in brief about bad effects of deficit financing and focus on explaining how deficit financing is not always bad.

Introduction

Deficit financing means generating funds to finance the deficit which results from excess of expenditure over revenue. The gap being covered by borrowing from the public by the sale of bonds or by printing new money. The recent impact of COVID-19 pandemic has led to widening of fiscal deficit which will be required to be filled by either printing money or borrowing.India prefers borrowing over printing due to ill effects of printed money.

Body

Positives of deficit financing

- There has been a huge expansion in governmental activities. It has forced governments to mobilize resources from different sources. As a source of finance, tax-revenue is highly inelastic in poor countries. Also, governments in these countries are under political compulsion not to impose newer taxes. If they do so they may lose political support of the electorate. Additionally, public borrowing is also insufficient to meet the expenses of the state. In this scenario, deficit financing does not give any trouble either to the taxpayers or to the lenders who lend their surplus money to the government.
- In India, deficit financing is associated with the creation of additional money by borrowing from the Reserve Bank of India. Interest payments to the RBI against this borrowing come back to the Government of India in the form of profit. Thus, this borrowing or printing of new currency is virtually a cost-free method. In sharp contrast to this, borrowing involves payment of interest cost to the lenders.
- Financial resources that a government can mobilise through deficit financing are certain and the exact figures are known before. The financial strength of the government is determinable if deficit financing is made.
- Deficit financing is an inflationary method of financing. However, the rise in prices must be a short run phenomenon. In any case, a mild dose of inflation is necessary for economic development. If inflation is kept within a reasonable limit, deficit financing ends up promoting economic development. Consequently, it neutralizes the disadvantages of price rise.
- Deficit financing has certain multiplier effects on the economy. This method encourages the government to utilize unemployed and underemployed

resources. This results in more incomes and actually ends up promoting employment in the economy.

Disadvantages of deficit financing

- It is actually a self-defeating method of financing. This is so because it always leads to an inflationary rise in prices and proves to be a vicious cycle as some countries go for persistent deficit financing.
- Deficit financing-induced inflation helps to produce classes and businessmen to flourish. However, fixed-income earners suffer very much during inflation. This increases the gap between the two classes. Consequently, income inequality increases.
- Another significant negative fallout of deficit financing is that it creates significant distortion in investment pattern. Actually, the investors have a higher profit motive. So, they tend to invest their resources in quick profit-yielding industries. However, investment in such industries is not beneficial in the interest of a country's long-term economic development.
- Deficit financing may not produce beneficial results in the creation of employment opportunities. Generally, additional employment opportunities are not created in poor resource-deficient countries. This happens because these countries lack raw materials and types of machinery even if adequate finance is made available via the instrumentality of deficit financing.
- Under inflationary conditions, the value of money goes down. In this scenario, the purchasing power of money declines. Consequently, a country experiences a flight of capital abroad for safe returns. This leads to a scarcity of capital.
- This deficit financing method causes a larger volume of the deficit in a country's balance of payments scenario. This happens because after an inflationary rise in prices there is a decline in exports while import bill keeps on rising. In this scenario, resources get transferred from export industries to import- competing industries.

Conclusion

Despite the perils associated with deficit financing, it is quite inevitable that the governments in poor and developing countries will employ this method of financing. It is a necessary evil. It is almost like a double-edged sword. Its success is actually premised upon the way in which it is used. It can be very successful if robust anti-inflationary measures are employed to combat inflation. The key challenge lies in keeping the inflation within a reasonable limit.This has been witnessed by all the countries after the Covid-19 impact and its longterm effect of current policies will be visible in future.

2. In the present economic situation of the country, do you think it is feasible to adhere to the fiscal deficit target of 3%. Critically Examine.

Approach

Define what is fiscal deficit and mention the cures fiscal deficit of India.In next part address both the need of targeted fiscal deficit approach and how in crises situation such as pandemic this is not a prudent approach.

Introduction

Fiscal deficit for 2020-21 was at 9.3 per cent of the gross domestic product (GDP), lower than 9.5 per cent estimated by the Finance Ministry in the revised Budget estimates, according to the CGA data. In absolute terms, the fiscal deficit works out to be Rs 18,21,461 crore.This data clearly shows on how the 3 percent fiscal deficit target cannot be adhered to in times of pandemic led disruption and also in normal times there needs to be some flexibility as per the situation and context.

Body

A government that abides by the FRBM rules enjoys greater credibility among the rating agencies and market participants – both national and international.As the years have rolled by, fiscal deficit has become a key factor to watch out for in every Budget presentation. It is considered the most important marker of a government's financial health.
The Fiscal Responsibility and Budget Management Act, which was initiated in 2003which lays target of 3% fiscal deficit has been tweaked several times since then, lays down the red lines for all types of government deficits including fiscal deficit. A government that abides by the FRBM rules enjoys greater credibility among the rating agencies and market participants – both national and international.

Fiscal prudence is necessary for balanced growth

- A targeted fiscal deficit leads to prudence in economic expenditure.This helps to keep balance sheet of any country in check and avoiding the necessary risks of over spending out of its limit.
- It leads to policies which have economic and rational basis rather than which have vote bank or moral hazards such a repeated farm loan waivers.
- A high and uncontrolled fiscal deficit was the reason for India's balance of payment crises.Therefore a gradual reduction and targeted approach after 2004 have led to increase in forex reserves .
- It increases India's credibility in global market and leads to better investment by foreign investors.Also fiscal deficit leads to crowding out effect which hampers new investors.
- It have positive effect on sovereign ratings of any country which is important to get better loans both for public and privately purposes.

- It checks inflation which reduces the income in hand of people and especially hurts the poor and savings and investment in a economy.

Overall a sustainable fiscal deficit leads to stable growth rate and checks inflation in the economy which is necessary even in times of crises.

Reasons to do away with the 3% fiscal deficit target.

- In past the 3% fiscal deficit target has not been adhered even normal times and therefore it doesn't make any rationale to stick to this in crises times.This is also supported by FRBM act itself which gives this flexibility.
- The government is sole investor in such crises period and therefore when private investors will shy away from investing in crises situation the government and its PSU can take a lead even at the expense of fiscal targets.
- Millions of people have lost job and India's job crises was already acute.Therefore to support this segment financially it is necessary to grant them benefits under MGNREGA and other initiatives to sustain healthier livelihood.
- Social security measures such as food grain, shelters for migrants , compensation and rehabilitation of orphans need resources and therefore the fiscal target will be breached.
- The health sector which has been at receiving end of the pandemic needs huge investment to ward of any future wave of corona virus and also to cater to longterm effects of covid.Therefore government have increased investment in oxygen plants, testing facilities and ICU infrastructure.
- The vaccination policy and vaccination of overall population is necessary for bringing economy back on track.Indian government has already kept aside 35000 crore in budget and will possibly require equal amount for vaccination of all.
- The government has announced a Atmanirbhar Bharat package which is @0 percent of GDP.This alone will breach the 3% target.This package is essential to revive msme sectors and manufacturing.

Conclusion

India's FRBM act which has set predetermined targets is also flexible as per the needs of the economy.In crises situation it has an escape clause which have been used in 2008 subprime crises and also in 2020 corona pandemic .But it has also been breached in normal times which points towards deeper issues with the overall fiscal targeting mechanism.This needs to be overhauled once the nation passes the corona test successfully for longterm sustainability of the economy and prosperity of the nation.But for now the 3% target can be ignored to focus on more pressing issues at hand.

3. Engaging in talks with Pakistan and Taliban is a strategic imperative for India. Do you agree? Critically comment.

Approach

In introduction focus on writing what have been recent approach of India towards Taliban and Pakistan.In next part mention why is it a strategic imperative to engage with both.In next part mention the risks involved in such engagement.In conclusion summarise the premise with positive outlook for India.

Introduction

Indian security situation in Jammu and Kashmir and the Eastern border along the China has be precarious in recent times.This is exacerbated by the withdrawal of US and NATO forces from Afghanistan which has had security fallout for India in 1990's when there was a similar move by US.Therefore to overcome these scenarios it has become strategic imperative for India to engage with Taliban and Pakistan for regional security and longterm diplomatic relationship.

Body

India has also been talking to the Taliban, which it long derided as surrogates for the Pakistani army, reflecting the increasing likelihood that the mullahs will reclaim power in Kabul following the withdrawal of US forces from Afghanistan in September. Furthermore, India has kept two of its consulates in Afghanistan closed since last year, a long-standing Pakistani demand that it had resisted for two decades.Both these recent stands shows India's change in foreign policy of both to not engage with Taliban and to talk with Pakistan even when the terror operations are pretty much intact.

Reasons for talking to Taliban and Pakistan :A strategic imperative

Taliban talks and its importance

- The development highlights the transition from a nonexistent relationship to the onset of a diplomatic engagement, underscoring New Delhi's acknowledgment of the Taliban as a critical component of future Afghanistan.
- India's willingness to engage largely stems from the concern about a potential upswing in anti-India militant groups in Afghanistan, including the Pakistan-based Lashkar-e-Taiba (LeT), Jaish-e-Mohammed (JeM), and al-Qaida in the Indian Subcontinent (AQIS), particularly with the Taliban's increasing territorial dominance.
- The security threat is highly pertinent given the deep-rooted historic ties of the aforementioned militant outfits with the Afghan Taliban, as well as the association of certain factions with Pakistan's Inter-Services Intelligence (ISI). After all, the Taliban-supported 1999 Kandahar hijacking served as a watershed in India's history of terrorism.

- Developments in Afghanistan are happening alongside persistent domestic resentment in Kashmir over the revocation of the region's special status, granted under the Article 370 of the Indian Constitution, in August 2019. An AQIS communication in March 2020, calling for the group to strengthen its position in the India-administered Jammu and Kashmir region, corroborated New Delhi's apprehensions.
- Taliban talks are efforts to regulate Islamabad's influence in the process. Additionally, with China in the picture, the regional race for influence in Afghanistan is unlikely to alleviate in the near future.
- India's reported billion-dollar investments in Afghan developmental projects further dictates New Delhi's interests.
- The engagement points to the Taliban's efforts to gain international relevance and posture itself as a legitimate political entity by engaging with the regional players.

Pakistan talks and its importance

- India has been locked in a border stand-off with China since last year and does not want the military stretched on the Pakistan front.
- The revocation of Article 370 in Jammu and Kashmir have not made matters still conducive for local prosperity and further with Pakistan based militants engaging in consanguinity indoctrination it comes much harder to attain local peaceful.Thus the talks with Pakistan to stabilise the situation is a priority for the government.
- The withdrawal from Afghanistan of the Western forces which might lead to percolation of anti-India terrorist in Kashmir via Pakistan can be stopped by cordial relations with Pakistan.
- The talks with Pakistan is also essential to reduce the terror camps, stick to ceasefire for peace and prosperity of people on the border region of Jammu and Kashmir.

Apprehension with Talks with Taliban and Pakistan

- New Delhi's trust deficit is unlikely to be mitigated, considering the Taliban have played host to vast anti-India militant outfits in the past.
- India's inevitable skepticism is further a product of the enduring anti-India position of the Haqqani Network, an autonomous branch of the Taliban with a deep affiliation to Pakistan's security elements.
- The Taliban could go back on its promises and, with a nudge from Pakistan, target Indian interests.
- The Taliban interlocutors India is engaging with (the same figures the US is talking to, such as Mullah Baradar) could be sidelined, or worse, replaced by pro-Pakistan hardliners such as the Haqqanis. This is a considerable risk.
- Taliban factions on the ground have not broken ties with the al-Qaeda and the Lashkar-e-Taiba. Notably, they are also sheltering anti-Pakistan Tehrik-e-Taliban Pakistan elements as an insurance. In this context, the closure of India's Jalalabad and Herat consulates due to persistent threats offers good reason for scepticism.

- Outreach to the Taliban could expedite Kabul’s fall, and complicate India’s relations with existing allies. This argument has been potent enough to prevent an India-Taliban channel to develop at various moments since 2010, when the idea of talking to the Taliban became internationally acceptable.
- Pakistan have been using state sponsored terror as a strategic policy to target India ans therefore it may not be changing this policy drastically anytime soon.
- Pakistan has always been fraught pf Indian engagement with Afghanistan and it would want to eliminate India from Afghanistan scene once the forces leave.
- China is closest ally of Pakistan and Indian recent overtures may be short-lived.

Conclusion

The India-Taliban engagement is still at a very early stage, and both sides are expected to be wary of each other’s moves and motives. Concurrently, observers from Kabul and Islamabad are expected to closely monitor any progress, with Pakistan already exhibiting its discomfort over the developments. In the coming term, India should further widen its engagement with other regional nations including Russia and Iran, and explore possibilities of cooperation to avoid alienation in Afghanistan’s future.